Supreme Court, U.S.
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80-505

No. .....

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ROSALIE M. ARLINGHAUS, individually and as Executrix of the Will of Frank H. Arlinghaus, deceased,

Petitioner,

v.

J. RICHMOND RITENOUR and JOHN J. LIPSKY,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

1. Did the Court of Appeals err in ruling that a finding of fact adverse to an appellee may be set aside, even though:

(a) the appellee did not attack the finding of fact by filing a cross-appeal from the District Court's judgment;

(b) the appellee did not raise the finding of fact as an issue presented for review in its brief in the Court of Appeals; and

(c) the finding of fact was essential to the integrity of the judgment entered by the District Court against the appellee's co-defendant, the claims against whom were settled after entry of the District Court judgment?

2. Did the Court of Appeals err in holding that Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder do not impose a duty on officers and directors of a closely-held corporation who purchase stock in the corporation from one of its shareholders to disclose to the selling shareholder the identity of parties that have expressed an interest in acquiring the corporation and the existence and status of on-going discussions with respect to a possible merger?

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OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit as to which review is sought, reported at 622 F.2d 629, the orders of that Court denying petitioner's petition for rehearing and rejecting her suggestion for rehearing in banc, not yet reported, the opinion of the District Court for the Southern District of New York, reported at Fed.Sec.L.Rep. (CCH) ¶95,288, and the opinion of the Court of Appeals for the Second Circuit dismissing an appeal of an earlier judgment and vacating that judgment, reported at 543 F.2d 461, appear in the Appendix.

JURISDICTION

On May 14, 1980, the United States Court of Appeals for the Second Circuit affirmed the judgment of the

District Court for the Southern District of New York, entered on March 6, 1979. Petitioner's timely petition for rehearing was denied, and her timely suggestion for rehearing in banc rejected, on July 1, 1980. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS AND RULES INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange

* * *

(b) To use or employ, in connection with the purchase or sale

of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

*

S.E.C. Rule 10b-5, 17 C.F.R. § 240.10b-5

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

*

Rule 28 of the Federal Rules of Appellate Procedure, in relevant part, provides:

Briefs

(a) Brief of the Appellant. The brief of the appellant shall contain under appropriate headings and in the

order here indicated:

* * *

(2) A statement of the issues presented for review.

* * *

(b) Brief of the Appellee. The brief of the appellee shall conform to the requirements of subdivision (a)(1)-(4), except that a statement of the issues or of the case need not be made unless the appellee is dissatisfied with the statement of the appellant.

* * *

STATEMENT OF THE CASE

1. Introduction

Petitioner, Rosalie M. Arlinghaus ("Mrs. Arlinghaus"), is the widow and executrix of the will of Frank H. Arlinghaus, the founder and, until his death, the largest stockholder of Modern Teleservice, Inc. ("Teleservice"), a closely held corporation. Respondent J. Richmond Ritenour ("Ritenour"), the president of Teleservice, and respondent John J. Lipsky ("Lipsky"), its executive vice-president, were the executive officers of the company and members of its board of directors. Mrs. Arlinghaus, a physical therapist by profession, played no role in the management or operation of Teleservice, did not sit on its board of directors and was not

experienced in business or securities transactions.

Mrs. Arlinghaus brought this action against Ritenour, Lipsky, Sidney Pepper (attorney for Mrs. Arlinghaus and the estate and general counsel of Teleservice) and Miriam Pepper (Sidney Pepper's wife) to recover her damages as a result of defendants' violations of their fiduciary obligations and their disclosure obligations under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5.

The claims for relief arose in connection with the purchase by Ritenour, Lipsky and Miriam Pepper from Mrs. Arlinghaus of all of the Teleservice stock held in her own name

and 40% of that held by her as executrix of her husband's estate.* They paid $10.00 per share for that stock and, shortly thereafter, consummated a transaction in which all of the assets of Teleservice were sold to Sonderling Broadcasting Corporation ("Sonderling") for Sonderling stock, which was thereafter distributed to the Teleservice stockholders in liquidation of the company.

In the Sonderling distribution, the Teleservice stockholders, including Ritenour and Lipsky, received Sonderling stock worth approximately $60.00 for each share of their Teleservice stock. Thus, the sale of Teleservice to Sonderling brought

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* Mrs. Arlinghaus sold a total of 13,104 shares in the transaction; Ritenour and Lipsky each acquired 4,914 shares, and Miriam Pepper acquired the remaining 3,276 shares.

Ritenour, Lipsky and Miriam Pepper an immediate profit of $50.00 for each of the shares they had purchased from Mrs. Arlinghaus for $10.00.*

Jurisdiction in the District Court was predicated on 28 U.S.C. §1331, 28 U.S.C. §1332 and 15 U.S.C. § 78aa.

2. Background

In 1966, Ritenour and Lipsky were given a mandate by Teleservice's board of directors to seek a suitable merger partner for Teleservice. After several preliminary discussions, they reported their inability to find a company willing to acquire Teleservice for an acceptable price, and the board

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* Because Ritenour and Miriam Pepper did not dispose of their Sonderling shares until those shares had appreciated substantially, their actual profits from the Arlinghaus shares was substantially greater. In her complaint, Mrs. Arlinghaus demanded an accounting for all profits by Ritenour and Miriam Pepper and damages against Lipsky.

authorized the abandonment of their efforts to do so.

In the spring of 1967, however, further negotiations were conducted by them, and a syndicate of investors headed by one Lewis Stat ultimately offered to acquire the company. Stat agreed to pay up to $1.2 million ($20.40 per share) for Teleservice's stock, and Ritenour and Lipsky agreed to use their best efforts to secure stockholder approval of the transaction.

As the Stat transaction was finally structured, a tender offer was made in the names of Ritenour and Lipsky. For their efforts in obtaining stockholder approval, Stat agreed that Ritenour and Lipsky would receive (i) 25% of the company's stock and (ii) cash in an amount equal to 25% of the

difference between the actual purchase price and $1.2 million, if they were able to secure approval at a lower price. In short, Stat and his group were willing to pay approximately $27 per share for 75% of Teleservice's stock, and Ritenour and Lipsky were to use their best efforts to secure stockholder approval of Stat's offer in exchange for the remaining 25% of the company; in addition, rather than pressuring Stat for the maximum amount that they could negotiate for the stockholders (as their fiduciary obligations required), Ritenour and Lipsky obtained Stat's agreement that, if they were successful in accomplishing the transaction for less than what Stat had agreed to pay, they would receive a monetary reward.

Ritenour and Lipsky were successful in obtaining the agreement of the stockholders, who were ignorant of the terms of Ritenour's and Lipsky's side agreement with Stat, to sell their stock for $20.00 a share. The Stat syndicate, however, failed to produce the required funds at the time of the scheduled closing, and the sale fell through.*

After the failure of the Stat deal, Ritenour and Lipsky commenced negotiations with a number of other potential merger partners, business brokers and investment bankers concerning the possible sale of the company. At the same time that those discussions were

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* Stat requested an extension of time for the closing, with an assurance that he could raise the funds, but Sidney Pepper, on Mrs. Arlinghaus's behalf but without her knowledge, denied his request.

taking place, Sidney Pepper suggested to Ritenour and Lipsky that the three of them form a syndicate to acquire a substantial portion of Mrs. Arlinghaus's stock. Ritenour and Lipsky agreed, and Pepper devised the purchase formula and drafted their proposal to Mrs. Arlinghaus, his client.

Under the terms of the proposal, Ritenour, Lipsky and Miriam Pepper* were to acquire the stock for $10.00 ($3.00 in cash and $7.00 in notes). Mrs. Arlinghaus retained an option to repurchase the stock at $10.00 a share if Teleservice were not sold within one year for a price which would yield her an average price of $20.00 per share for her own and the

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* For tax purposes, Sidney Pepper elected to purchase the stock in his wife's name.

estate's holdings.* At no time during the pendency of their offer to purchase Mrs. Arlinghaus's stock did Ritenour, Lipsky, Pepper -- or anyone else -- tell Mrs. Arlinghaus of the existence of ongoing negotiations for the sale of Teleservice, the identity of the interested parties or the status of the negotiations. Indeed, Ritenour and Lipsky disclosed literally nothing to Mrs. Arlinghaus, since Sidney Pepper handled the negotiations for the three of them.

Approximately six months after the purchase of the Teleservice

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* There is a basic misconception in the Court of Appeals opinion with respect to the repurchase option. The Court stated that $20.00 per share was the "real price" offered by Ritenour and Lipsky for Mrs. Arlinghaus's stock. (App., p. 37) It was not. They paid her $10.00 per share for her stock and would under no circumstances be required to pay her a penny more. The conditional repurchase options did not in-

(footnote continued)

stock from Mrs. Arlinghaus, Ritenour, Lipsky and Sidney Pepper arranged for the sale of Teleservice's assets to Sonderling. In that transaction, the Teleservice stockholders received shares of Sonderling stock, listed on the New York Stock Exchange, worth approximately $60 for each share of Teleservice. Ritenour, Lipsky and Pepper derived net profits of more than $650,000 on the Teleservice stock sold to them by Mrs. Arlinghaus several months earlier for approximately $130,000.

3. The District Court Opinion

After a non-jury trial, the

(footnote continued)

crease the amount she received from Ritenour and Lipsky, nor did it diminish their profits from the transaction. The greater the corporate value (known only to Ritenour and Lipsky), the greater Mrs. Arlinghaus's loss on the sale of her stock to them, the greater their profit, and the more egregious their fraud.

District Court held that Sidney Pepper had violated his fiduciary obligations to Mrs. Arlinghaus and was liable to account to her for his profits from the transaction. The Court also awarded Mrs. Arlinghaus punitive damages against Sidney Pepper in an amount equal to the compensatory damages determined in the accounting.

The Court ruled that Pepper had violated his duties as an attorney by (i) misrepresenting to Mrs. Arlinghaus that Ritenour and Lipsky would resign if Mrs. Arlinghaus did not agree to sell her stock on the terms they had offered; and (ii) failing to disclose to Mrs. Arlinghaus that Ritenour and Lipsky had determined during their merger negotiations that Teleservice had a probable corporate value of be-

tween $2 million and $3 million ($34-$51 per share). Although the Court held that Mrs. Arlinghaus had not relied on the affirmative misrepresentation, it ruled that Pepper's concealment of Teleservice's probable value was material to Mrs. Arlinghaus's decision to sell on the terms offered by him, Ritenour and Lipsky.

The District Court dismissed the claims against Ritenour and Lipsky because it held that they had discharged their disclosure obligations by disclosing to Sidney Pepper all material facts, including their knowledge of the probable value of Teleservice -- knowledge derived from their negotiations with Teleservice's suitors. Since Sidney Pepper was Mrs. Arlinghaus's attorney, the District Court

imputed his knowledge, gained from Ritenour and Lipsky, to her.

The District Court dismissed Mrs. Arlinghaus's claims under Section 10(b) of the Securities Exchange Act on the ground that Mrs. Arlinghaus had failed to use due diligence in connection with the sale, since she had not conducted an independent investigation of the value of the company but had relied entirely on Pepper.

4. The Court of Appeals Opinion

The Court of Appeals ruled that Ritenour and Lipsky were fiduciaries with respect to Mrs. Arlinghaus and that they did not discharge their disclosure obligations to her by "disclosures" to Sidney Pepper, since they were well aware that Pepper, their part-

ner in the transaction, was in a position adverse to that of Mrs. Arlinghaus.

Rather than reversing the judgment in favor of Ritenour and Lipsky, however, the Court of Appeals ruled that the District Court had erred in its finding that Ritenour and Lipsky had knowledge that Teleservice's probable corporate value was between two and three million dollars (the "Finding of Fact"). Having set aside the Finding of Fact,* the Court held that

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* In reviewing the testimony (App., pp. 9-27; 34-39), the Court of Appeals failed to address Mrs. Arlinghaus's contention that the Finding of Fact rested on respondents' testimony with respect to merger negotiations and on possible inferences drawn from the failure of respondents, who had the burden of proof, Pepper v. Litton, 308 U.S. 295, 306 (1939); Perlman v. Feldmann, 219 F.2d 173, 177-78 (2d Cir.), cert. denied, 349 U.S. 952 (1955), to adduce evidence, documentary or testimonial, of material facts. II Wigmore, Evidence § 285 (Chadbourn rev. 1979). The Court also did

(footnote continued)

Ritenour and Lipsky had no information about the company that they were required to disclose to Mrs. Arlinghaus. In so holding, the Court ignored Mrs. Arlinghaus's claim that Ritenour and Lipsky were obligated to disclose to her the identities of all parties who had expressed an interest in acquiring Teleservice, the offers and counter-offers made in response to those expressions of interest and the status of all negotiations with respect to a possible sale.

(footnote continued)

not address Mrs. Arlinghaus's contention that the Finding of Fact rested primarily on oral testimony and thus was immune from appellate review under Fed.R.Civ.P. 52(a). It is not even clear that the Court of Appeals used the appropriate standard in reviewing the Finding of Fact since nowhere in its opinion did it state that the Finding of Fact was clearly erroneous, nor did it even characterize the Finding of Fact as a finding of fact.

REASONS FOR GRANTING THE WRIT

1. THE CIRCUMSTANCES UNDER WHICH AN UNCONTESTED FINDING OF FACT ADVERSE TO AN APPELLEE OR RESPONDENT IS SUBJECT TO MODIFICATION BY AN APPELLATE COURT HAVE NOT BEEN BUT SHOULD BE DEFINED BY THE SUPREME COURT

Ritenour and Lipsky did not file a cross-appeal attacking the Finding of Fact, nor did they raise the question whether the Finding of Fact was clearly erroneous in their brief to the Court of Appeals. The Court of Appeals nevertheless held that it was empowered to set aside the Finding of Fact since, it ruled, doing so had the effect of allowing it to affirm the District Court's judgment in favor of Ritenour and Lipsky, notwithstanding the errors of law committed by the District Court.

This Court has ruled that a

finding of fact adverse to an appellee may not be set aside in the absence of a cross-appeal if the result would be a "revision of the judgment." Morley Construction Co. v. Maryland Casualty Co., 300 U.S. 185, 191 (1937). The Court in Morley, however, explicitly left open the question whether such a finding of fact could be set aside when the judgment of the lower court is thereafter affirmed by the appellate court. Ibid.

Although, as discussed below, decisions of this Court subsequent to Morley appear to hold that such findings may never be set aside, no decision explicitly resolves the issue, and there is uncertainty among the lower courts, legal scholars and practitioners as to the precise contours

of the rule. Moreover, it does not appear that this Court has ever considered the issue in the context raised herein, i.e., where the rejection of a finding of fact destroys the integrity of the judgment below insofar as it relates to other parties in the trial court who were not parties to the appeal.

In addition, it does not appear that this Court has ever decided the scope of the preclusionary effect of Rule 28(b) of the Federal Rules of Appellate Procedure, which requires the appellee to list all issues the appellee wishes to present for appellate review (in addition to those raised by the appellant) in the appellee's opening brief. In the absence of this Court's guidance on the issue,

Courts of Appeals have, as discussed below, rendered inconsistent rulings on the question whether such issues may ever be reviewed by the Court of Appeals or, if so, the circumstances under which such review is appropriate. Because of the importance of these questions to practitioners and judges in the federal judicial system, petitioner respectfully suggests that they should be resolved by this Court.

A. THIS COURT SHOULD DECIDE WHETHER AN APPELLEE'S OR RESPONDENT'S FAILURE TO CROSS-APPEAL OR TO CROSS-PETITION IMMUNIZES AN ADVERSE FINDING OF FACT FROM ATTACK

Ritenour and Lipsky did not file a cross-appeal to contest the Finding of Fact. It would appear, therefore, that, under prior decisions of this Court, they were bound by that finding. See, e.g., Alaska Industrial

Board v. Chugach Electric Association, Inc., 356 U.S. 320, 324-25 (1958).

The Court of Appeals, however, citing Langnes v. Green, 282 U.S. 531 (1931), ruled that the Finding of Fact was subject to attack even in the absence of a cross-appeal because the effect of overruling the finding was to affirm the District Court's judgment. In doing so, the Court of Appeals distorted the Langnes rule and ignored the holdings of more recent decisions of this Court. Moreover, it relied in its opinion on a frequently-cited law review article that has only compounded the complexity and confusion surrounding the issue. Because the decision of the Court of Appeals is the first reported decision that explicitly includes ad-

verse findings of fact within the Langnes rule and because its decision gives a significant judicial imprimatur to a law review article that ignores the important distinction between adverse findings of fact and adverse theories or conclusions of law, it is important for this Court to resolve this significant and basic question at this time.

The so-called Langnes rule* does not, as the Court of Appeals ruled in this case, allow an appellee who has not cross-appealed to attack an adverse finding of fact -- even if the attack on the finding of fact is

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* The Langnes case itself was an admiralty case. As a result, the appeal permitted a trial de novo in the appellate court. Standard Oil Co. v. Southern Pacific Co., 268 U.S. 146, 155 (1925); Irvine v. The Hesper, 122 U.S. 256, 266 (1887). Thus its articulation of what has become known as the Langnes rule is dictum.

consistent with an affirmance of the judgment below. The rule, actually enunciated in United States v. American Ry. Express Co., 265 U.S. 425, 435 (1924), does permit an appellee to support a judgment by (i) attacking the legal analysis of the lower court or (ii) pointing to additional facts concerning matters that were overlooked or ignored by the lower court. Neither Langnes v. Green nor United States v. American Ry. Express Co. deals with an effort to set aside a finding of fact.

The question whether an appellee can attack findings of fact was, as noted above, considered by this Court in Morley Construction Co. v. Maryland Casualty Co., supra. Citing The Maria Martin, 12 Wall. 31

(1870), the Court ruled:

> "Findings may be revised at the instance of an appellant, if they are against the weight of evidence, where the case is one in equity. This does not mean that they are subject to like revision in behalf of appellees, at all events in circumstances where a revision of the findings carries with it as an incident a revision of the judgment." 300 U.S. at 191.

Although the Court in Morley expressly left open the question whether an appellee can attack a finding of fact when a rejection of that finding would not disturb the judgment below, ibid., subsequent decisions have clarified the rule.

For example, it is well-settled that an appellee who does not cross-appeal cannot attempt to support a money judgment in his favor by urging that an improper allowance of certain of his claims was offset by the improper rejection of others. Helvering v.

Pfeiffer, 302 U.S. 247 (1937); Alexander v. Cosden Pipe Line Co., 290 U.S. 484 (1934).

In Alaska Industrial Board v. Chugach Electric Association, Inc., supra, this Court refused to consider the respondents' argument that a judgment of the Court of Appeals affirming a reversal of an Alaska Industrial Board decision could be affirmed by setting aside findings of facts upon which the Board's jurisdiction was predicated, holding:

> "Respondents maintain that Jenkins' claim was not timely filed and that for other reasons also the Board had no jurisdiction to enter this award. These questions were decided adversely to respondents by the Court of Appeals and no cross-petition was filed here. Those questions are therefore not open to respondents at this stage." 356 U.S. at 324-25.

See also Davis v. Murphy, 587 F.2d 362,

365 (7th Cir. 1978); United States v. Ogilvie, 334 F.2d 837, 842 n.2 (7th Cir. 1964), cert. denied, 379 U.S. 964 (1965).

Although the cases cited hold that a finding of fact can not be attacked by an appellee or respondent in the absence of a cross-appeal or cross-petition, the meaning to be accorded to those decisions is, as is evidenced by the decision of the Court of Appeals in this case, unsettled.

In essence, the question in dispute is whether the rule (i) generally allows an attack by an appellee or respondent on findings of fact made by the lower court except for findings relevant to certain legal issues or (ii) prohibits setting aside findings of fact, while allowing attacks on the lower court's legal analysis and con-

clusions and allowing the reviewing court to make additional findings of fact with respect to issues overlooked or ignored by the lower court. See, Stern, "When to Cross-Appeal or Cross-Petition -- Certainty or Confusion," 87 Harv. L. Rev. 763 (1974), the article cited by the Court of Appeals in its decision herein, which argues that the former interpretation is the proper one, although the author concedes that there is no opinion reconciling the Langnes rule and the holdings in Chugach and the other cases cited above. Indeed, the author concludes:

> "[T]he result of the recent decisions is to leave considerable doubt as to when counsel for appellees, or for respondents in the Supreme Court, must cross-appeal or cross-petition." 87 Harv. L. Rev. at 764.

Because the Court of Appeals

has in the instant opinion, apparently for the first time, explicitly held that adverse findings of fact are subject to attack even in the absence of a cross-appeal, the confusion and uncertainty that already existed will only be exacerbated. The issue is one that must be faced on an almost daily basis by practitioners and judges. It should be resolved by this Court.

B. THIS CASE ALLOWS THE COURT TO DECIDE WHETHER A FINDING OF FACT MAY BE SET ASIDE IN THE ABSENCE OF A CROSS-APPEAL WHEN SUCH A RULING DESTROYS THE INTEGRITY OF A JUDGMENT AGAINST ANOTHER PARTY

As its opinion makes clear, the Court of Appeals recognized that it was powerless to set aside a finding of fact that would require a revision of the judgment against Ritenour and Lipsky. The Court itself also questioned

the propriety of rejecting a finding of fact if such a rejection would "unsettle any portion of the district court's judgment, including the resolution of the claims against Pepper." (App., p. 41) The Court went on to suggest that there was support in the record for the judgment against Pepper even without the Finding of Fact and ultimately concluded that "[i]n any event, the judgment against Pepper now stands inviolate as a result of the settlement between his estate and Mrs. Arlinghaus." (Id., pp. 42-43)

The Court of Appeals erred in holding that the rejection of the Finding of Fact did not unsettle the portion of the judgment against Pepper. Indeed, as shown below, if the portion of the judgment that held Pepper liable

is still valid, the Court was required, as a matter of law, to reverse the portion of the judgment in favor of Ritenour and Lipsky.

(1) The Portion of the Judgment Against Pepper Has Been Unsettled. The Court of Appeals ruled, correctly, that the District Court found that Pepper violated his fiduciary obligations to Mrs. Arlinghaus by (i) affirmatively misrepresenting Ritenour's and Lipsky's intent to resign from the company and (ii) failing to disclose their knowledge of the probable corporate value of Teleservice. The Court of Appeals reasoned that the former of these findings would support the judgment if the latter finding were reversed.

The Court failed to note that

the District Court had found that Mrs. Arlinghaus did not act in reliance on the affirmative misrepresentation. (App., pp. 82, 85)* Thus, as a matter of law, Mrs. Arlinghaus did not suffer any damages as a result of the affirmative misrepresentation, and rejection of the Finding of Fact destroys the only basis for the judgment against Pepper.

Because of the post-judgment settlement with Pepper's estate, it is true that the judgment against Pepper will not literally be "revised," the result that was expressly prohibited by Morley, supra. Nevertheless, the principle enunciated by the Court of Appeals in this case undermines the basis of the rule enunciated in Morley, i.e.,

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* In another part of its opinion the Court of Appeals had explicitly upheld this finding. (App., p. 17)

that the failure to file a cross-appeal indicates satisfaction with the judgment below. This is especially important under the facts herein since, as shown below, the judgment against Pepper, if valid, when coupled with the District Court's findings that were upheld by the Court of Appeals, compels the entry of judgment against Ritenour and Lipsky. Thus, the facts of the case at bar go beyond those necessarily reached in Morley, and this Court should grant this petition to clarify its holding in that case and to prevent further erosion of the principles therein enunciated.

(2) If the Judgment Against Pepper Remains Valid, the Court of Appeals Erred in Affirming the Judgment in Favor of Ritenour and Lipsky. As

stated above, the judgment against Pepper was premised on the breach of his fiduciary obligations to Mrs. Arlinghaus. If, as the Court of Appeals suggests, that portion of the judgment was not unsettled by the rejection of the Finding of Fact, the Court of Appeals erred in not reversing, as a matter of law, the portion of the judgment in favor of Ritenour and Lipsky. The District Court found, and its findings in that regard were expressly upheld by the Court of Appeals, that Ritenour and Lipsky were aware of Pepper's breaches of his fiduciary obligations* and that they obtained a profit there-

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* For example, the Court of Appeals ruled that Ritenour and Lipsky knew that Pepper was willing to "pressure" Mrs. Arlinghaus to convince her to accept the Stat syndicate offer (App., pp. 14-15) and that they were aware of Pepper's "self-interested scheming" in connection with the sale of Mrs. Arlinghaus's and the estate's stock. (App., p. 31)

from. Under decisions of this Court, all that is required to hold a non-fiduciary jointly liable with a fiduciary is (i) knowledge of the breach and (ii) some benefit received from the wrongdoing. See Crites, Inc. v. Prudential Insurance Co., 322 U.S. 408, 414 (1944); Jackson v. Smith, 254 U.S. 586, 589 (1921). Cf. Irving Trust Co. v. Deutsch, 73 F.2d 121, 125 (2d Cir.), cert. denied, 294 U.S. 709 (1934).

In short, the Court of Appeals cannot have it both ways: either (i) its opinion impugns the integrity of the judgment against Pepper, in which case the opinion is inconsistent with this Court's decisions in Morley and its progeny, or (ii) it does not affect the basis for the Pepper judgment, in which case, its refusal to

reverse the District Court's judgment in favor of Ritenour and Lipsky is inconsistent with this Court's decisions in Crites and Jackson. In either event, the decision was erroneous as a matter of law.

C. THIS COURT SHOULD RESOLVE THE CONFLICT AMONG THE COURTS OF APPEALS CONCERNING THE PRECLUSIONARY EFFECT, IF ANY, OF A PARTY'S FAILURE TO RAISE AN ISSUE FOR REVIEW IN ITS BRIEF

Rule 28(b) of the Federal Rules of Appellate Procedure requires an appellee to list all issues presented for review in its brief in the Court of Appeals.* Ritenour and Lipsky did not question the adequacy of the evidence to support the Finding of Fact in their brief; indeed, as noted by the Court of Appeals, they did not attack

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* Rule 28(a)(2) contains a similar requirement for appellants.

the Finding of Fact until after the issue was raised by the Court sua sponte. The Court of Appeals ruled, however, that their failure did not preclude appellate review because (i) the issue had been raised in the District Court; (ii) the parties had had a full opportunity to develop the relevant facts; and (iii) the Court of Appeals provided an opportunity for additional briefing of the issue.

The standards thus set down by the Court of Appeals for the Second Circuit conflict with those of other Courts of Appeals. The Court of Appeals for the Third Circuit, for example, has held that the prohibition contained in F.R.A.P. 28 is absolute. Brown v. Sielaff, 474 F.2d 826, 828 (3d Cir. 1973) (unless the issue is raised

in the brief, the Court is "unable to notice it"). See also 9 Moore's Federal Practice ¶228.02[2.-2]. Other Courts of Appeals have required a finding of "exceptional circumstances" before the issue can be considered. See, e.g., Pedicord v. Swenson, 431 F.2d 92, 93 (8th Cir. 1970). In the instant case, the Court of Appeals made no finding of exceptional circumstances, nor could it have done so under the facts. Thus, and especially because of the recurrent nature of the issue, this Court should provide guidance with respect the appropriate interpretation to be given to the federal rules, by resolving the conflict between the instant decision of the Court of Appeals for the Second Circuit and the earlier decisions of the other Courts of Appeals that have considered the issue.

2. THIS COURT SHOULD RESOLVE THE CONFLICT IN THE DECISIONS OF THE COURTS OF APPEALS WITH RESPECT TO THE QUESTION WHETHER CORPORATE INSIDERS HAVE A DUTY UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 10b-5 PROMULGATED THEREUNDER TO DISCLOSE TO STOCKHOLDERS FROM WHOM THEY PURCHASE STOCK THE IDENTITIES OF PARTIES WHO HAVE EXPRESSED AN INTEREST IN ACQUIRING THE CORPORATION AND THE STATUS OF NEGOTIATIONS WITH THOSE PARTIES

As noted above, the District Court and the Court of Appeals found that Ritenour and Lipsky had negotiated with potential purchasers of Teleservice and had not disclosed the identities of those potential merger partners or the status of the negotiations to Mrs. Arlinghaus before they purchased her stock.

The Court of Appeals, in effect, absolved Ritenour and Lipsky of any duty to make such disclosures to Mrs. Arlinghaus, for it held that,

since (as it found) the negotiations had not progressed to a point where Ritenour and Lipsky had learned that Teleservice had a probable corporate value in excess of what they were paying Mrs. Arlinghaus for her stock, Ritenour and Lipsky had violated no disclosure duty.

The Court's holding in that regard conflicts with that of every other Court of Appeals that has considered the issue. See Holmes v. Bateson, 583 F.2d 542 (1st Cir. 1978); Thomas v. Duralite Co., 524 F.2d 577 (3d Cir. 1975); Rochez Bros., Inc. v. Rhoades, 491 F.2d 402, 409 (3d Cir. 1974); Childs v. RIC Group, Inc., 331 F.Supp. 1078, 1083 (N.D. Ga. 1970), aff'd, 447 F.2d 1407 (5th Cir. 1971). In each of those cases, the Court held that the

existence and status of merger discussions -- no matter how tentative or preliminary -- were facts material to an investor's decision whether to sell his or her stock in the corporation. In each case, the Court held that the failure to disclose all of the facts surrounding the potential merger discussions rendered the insider liable under Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder to the shareholder from whom he purchased stock.

In the instant case, however, the Court of Appeals absolved Ritenour and Lipsky from liability under the federal securities laws, notwithstanding its holding that they were fiduciaries with respect to Mrs. Arlinghaus, and even though it is undisputed that (i)

they disclosed nothing to her about their negotiations with potential merger partners; and (ii) they never disclosed to her the true nature of the Stat syndicate offer.

Perhaps the clearest example of a decision in direct conflict with that of the Court of Appeals herein is Rochez Bros., Inc. v. Rhoades, supra. In that case the plaintiff sold its stock in a closely held corporation to the defendant, the president of the company. Before the sale, the defendant had held discussions with two companies that had expressed some interest in acquiring the corporation, but in neither case had the terms of the potential acquisition even been discussed. Moreover, the transaction by which the sale of the company was ultimately effected

was with a buyer that had not been involved before the plaintiff sold its stock to the defendant. Nevertheless, the Court of Appeals for the Third Circuit ruled that the mere fact that companies had shown an interest in acquiring the corporation was material as a matter of law. 491 F.2d at 408-09. The Court held that the defendant was liable to the plaintiff for his profits on the stock acquired from the plaintiff -- even though the defendant had made it clear to the plaintiff at the time of the purchase that he believed the stock was worth more than the plaintiff thought it was -- because the defendant had failed to disclose the existence and status of the merger discussions.

It is important that this

Court resolve the conflict among the Courts of Appeals on this issue, especially given the frequency of tender offers in the financial community and the extraordinary effect that a tender offer can have on the market value of a company's stock. On the basis of the Court of Appeals decision in this case, insiders aware of discussions with potential merger partners are free to buy stock from the target company's shareholders who are ignorant of those discussions until the discussions have progressed to the point where the tender offeror's view of the company's probable corporate value has been established. Under the standards heretofore enunciated by other Courts of Appeals, the fact that one or more companies had expressed an interest in acquiring the

corporation, by itself, is sufficient to trigger the "disclose or abstain" rule for corporate insiders. Petitioner respectfully submits that, in view of the uncertainty the conflict will cause for members of the business community and for the lower courts, this Court should grant this petition in order to resolve the conflict.*

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* As pointed out above, the District Court dismissed Mrs. Arlinghaus's securities law claims against all of the defendants, holding that she had not satisfied her burden of proving "due diligence." The District Court's opinion was rendered prior to this Court's decision in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). Since the Hochfelder decision, the Courts of Appeals that have considered the issue (including the Court of Appeals for the Second Circuit) have universally rejected a "due diligence" requirement for plaintiffs in a 10b-5 case. See Mallis v. Bankers Trust Co., 615 F.2d 68 (2d Cir. 1980); Dupuy v. Dupuy, 551 F.2d 1005 (5th Cir.), cert. denied, 434 U.S. 911 (1977); Holdsworth v. Strong, 545 F.2d 687 (10th Cir. 1976), cert. denied, 430 U.S. 955 (1977); Straub v. Vaisman & Co., 540 F.2d 591 (3d Cir. 1976). Because of its disposition of the case, the Court of Appeals did not reach that issue in this case.

CONCLUSION

The split in the lower courts on the materiality of discussions with companies that have expressed an interest in acquiring the stock of another corporation, coupled with the need for guidance in determining when an appellate court is empowered to review a finding of fact adverse to an appellee, provides an opportunity for the ultimate resolution of these important issues by this Court. For all of the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 418 - September Term, 1979
Argued January 17, 1980
Decided May 14, 1980
Last Supplemental Brief
filed March 24, 1980.
Docket No.79-7483

ROSALIE M. ARLINGHAUS, Executrix
of the Will of FRANK H. ARLINGHAUS,
and ROSALIE M. ARLINGHAUS,
individually,

Plaintiff-Appellant,

- v. -

J. RICHMOND RITENOUR and JOHN J. LIPSKY,

Defendants-Appellees,

- and -

MIRIAM PEPPER and SIDNEY PEPPER,

Defendants.

B e f o r e :

FRIENDLY, MANSFIELD and KEARSE,

Circuit Judges.

Appeal from a judgment of the District Court for the Southern District of New York, Henry F. Werker, Judge, dismissing the complaint of plaintiff Rosalie M. Arlinghaus which alleged that defendants Ritenour and Lipsky defrauded her by entering into an agreement to purchase stock of Modern Teleservice, Inc. owned by her individually and as executrix of her husband's estate at less than what they knew to be its fair value. See Arlinghaus v. Ritenour, 543 F.2d 461 (2 Cir. 1976). Affirmed.

PREBEN JENSEN, Esq., New York, N.Y. (Casey, Lane & Mittendorf, New York, N.Y.), for Plaintiff-Appellant.

RAYMOND P. O'KEEFE, Esq., New York, N.Y. (Charles A. Scharf, P.C., New York, N.Y.), for Defendants-Appellees.

FRIENDLY, Circuit Judge:

This action, stemming from the sale

of stock to the officers of a closely-held corporation, is before us for the second time, see 543 F.2d 461 (1976). It was brought in 1968 in the District Court for the Southern District of New York by plaintiff, Rosalie M. Arlinghaus, individually and as executrix of the estate of her husband, Frank M. Arlinghaus. The gravamen of the complaint was that defendants Ritenour and Lipsky, who were principal officers and also directors of Modern Teleservice, Inc. (Teleservice), and Sidney Pepper, who served as attorney for Mrs. Arlinghaus, caused Mrs. Arlinghaus to sell stock in that company at what they knew to be an unconscionably low price, in breach of their fiduciary obligations and in violation of § 10(b) of the Securities Exchange Act and SEC rule 10b-5. Jurisdiction was predicated on diverse citizen-

ship and also on § 10(b) and § 27 of the Securities Exchange Act.

After extended gestation, the action came to trial before Judge Werker in May, 1975. In an unreported opinion the district court dismissed all claims against Ritenour and Lipsky, but held Pepper liable for breach of fiduciary duty and ordered an accounting of profits accruing from the resale of shares sold to Pepper's wife, Miriam. While the accounting was in progress, the district court entered final judgment under F.R.Civ.P. 54(b) on the claims against Ritenour and Lipsky. Mrs. Arlinghaus took a timely appeal, which, however, this court dismissed for lack of jurisdiction after finding that a final judgment extending only to Ritenour and Lipsky might prejudice a later appeal which we thought Pepper would be likely

to take after his accounting. See 543 F.2d at 463-64. The accounting was not concluded until November 9, 1978. On March 7, 1979, Judge Werker entered final judgment against Pepper's estate for $509,066 in compensatory and punitive damages, and again dismissed all claims against Ritenour and Lipsky as well as a separate claim against Miriam Pepper. The Pepper judgment was appealed by both sides, but a settlement for $175,000 was entered on September 17, 1979. This leaves before us Mrs. Arlinghaus' appeal of the dismissal of her claims against Ritenour and Lipsky.

This court's previous decision granted the parties leave to use the same submissions if the appeal was renewed, 543 F.2d at 464 n.4. Although availing themselves of this opportunity, they also submitted supplemental briefs

and later, at this court's request, filed a third series of briefs on an issue raised by us at oral argument, namely, the extent of appellees' knowledge of the market value of Teleservice's shares at the time of the purchase from Mrs. Arlinghaus.

THE FACTS

Teleservice, whose business was processing and distributing television commercials in New York and California, began as a division of Modern Talking Picture Service, Inc. (Talking Picture), a corporation founded by Frank Arlinghaus in 1937. Ritenour and Lipsky joined Talking Picture in the late 1940's, and, when Teleservice was spun off as an independent New York corporation in 1952, were appointed its president and vice president respectively. Their services were considered essential to Tele-

service's success. Pepper, who had handled most of Talking Picture's legal work, likewise became counsel to Teleservice as well as continuing to serve as attorney for Frank Arlinghaus and, after his death, for Mrs. Arlinghaus and the estate.

When Frank Arlinghaus died in August, 1964, appellant became the owner, in practical effect, of the majority of Teleservice's 58,800 outstanding shares. As of April 25, 1967, she held 4,000 shares (6.8%) individually, 20,360 shares (34.6%) as executrix of Frank Arlinghaus' estate, and 8,400 shares (14.3%) distributed among three custodian accounts for her children. The seven remaining shareholders together owned 26,040 shares (44.3%), of which 1,540 belonged to Ritenour and 700 to Lipsky.

From Teleservice's inception, its

shares were restricted by a buy-back agreement which provided inter alia that the estate of a deceased shareholder could require the corporation to purchase its shares at a formula price for a period of three years after the shareholder's death.[1] Because Frank Arlinghaus' estate faced a large tax assessment, Mrs. Arlinghaus, Pepper and Clemens Arlinghaus, appellant's brother-in-law and a member of Teleservice's board of directors, met in late December, 1966 to discuss whether the funds needed to pay the tax assessment should be raised by exercising the estate's "put" option under the buy-back agreement.

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[1] The stockholders' agreement also provided that if the estate of a deceased shareholder failed to transfer its shares to the trustee or immediate family of the shareholder within one year after the appointment of an executor, the remaining shareholders and the corporation would receive successive thirty-day options to purchase the estate's shares at the formula price.

However, this course was rejected, in part because the formula price of $16.00 per share fell below the $20.00 price that the participants considered attainable, the agreement provided for full payment over a lengthy four-year term, and, according to Pepper's deposition, Teleservice might not have been able to afford to purchase the estate's share in any event.

The estate's decision not to offer its shares for purchase by either the corporation or the remaining shareholders frustrated Ritenour and Lipsky's longstanding ambition to increase their Teleservice holdings.[2] By apparent

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[2] Ritenour testified to learning as early as 1965 that the estate was unlikely to make its shares available to the remaining stockholders, a claim that is consistent with the provisions of the stockholder's agreement, see note 1 supra. Ritenour's and Lipsky's longstanding desire for greater equity participation in Teleservice is evidenced by their unsuccessful attempt to meet an offer by Frank

coincidence, however, the Teleservice board of directors authorized a search for potential merger or acquisition partners sometime during 1966, in the expectation that Teleservice alone might not be able to meet its growing capital needs. Ritenour and Lipsky not only carried out this mandate but simultaneously investigated arrangements that might also increase their holdings in Teleservice. On October 14, 1966, Ritenour spoke to Seymour Mintz, a business broker, about the prospect of obtaining financing for the purchase of Teleservice on Ritenour's behalf. Although the Mintz contact eventually led to more promising ones with other brokers, it produced only one company,

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(footnote continued)

Arlinghaus to sell them the entire company for $275,000 in 1960.

Filmways, with a serious interest in Teleservice. According to Ritenour, Filmways was willing to "consider placing a price" on Teleservice of between five and eight times average earnings over the previous five years, that is, between $875,000 and $1,400,000 or $14.88 to $23.81 per share.[3] In addition to the Filmways negotiations, Teleservice was approached on a "yearly" basis by Chet Ross, the president of Bonded Film Services, a Teleservice competitor, to discuss a possible merger or acquisition deal. The record lacks any indication of the value placed on Teleservice by Ross until August 18, 1967, when Ross' company itself had been acquired by another firm; at that

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[3] Ritenour's deposition testimony indicated that Teleservice's average earnings over the previous five years had been roughly $175,000, hence the price range between $875,000 and $1,400,000.

point, Ritenour related that Ross had also mentioned a price range between five and eight times average earnings. When Ritenour was asked whether he had responded to Ross' probes with a figure that Teleservice might find satisfactory, he stated "[i]f I did, it would have been around the 3,000,000 mark" (or $51 per share) -- a proposal that, if made, would have been at some unidentified date between March 14 and August 18, 1967.[4]

In April, 1967, Ritenour's investigations began to bear some fruit.

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[4] Ritenour's deposition later retracted either the $3,000,000 figure or the dates involved. However, his trial testimony indicates that he may have used a $3,000,000 asking price on at least one other occasion, namely, in informal negotiations conducted with Screen Gems, see discussion infra. The record is also hazy about when these negotiations took place, but is possible that they began as early as June, 1967. By generous inference, then, Ritenour's asking price for Teleservice was in the neighborhood of $3,000,000 during the spring or summer of 1967.

Through circuitous contacts beginning with Mintz, Teleservice was called to the attention of another broker, Harris Shapiro, who in turn organized a small syndicate of investors headed by one Lewis Stat (the syndicate). After brief negotiations, the syndicate agreed to finance a tender offer in the names of Ritenour and Lipsky for all outstanding shares of Teleservice. The agreement, embodied in a letter from Stat dated April 23, 1967, provided that if Ritenour and Lipsky could persuade Teleservice's shareholders to sell, the syndicate would merge Teleservice into a new corporation; that Ritenour and Lipsky would each receive a 12.5% interest in this corporation; and that, in addition, they would be "gifted" with 25% of the difference between the purchase price paid to Teleservice share-

holders and $1,200,000 (in other words, the lower the price paid to the shareholders, the larger the cash bonus to Ritenour and Lipsky). A separate understanding with the syndicate provided inter alia that if the deal succeeded, Ritenour and Lipsky would receive five-year employment contracts with the new corporation at their established salaries.

On, or slightly before, April 25, 1967, Ritenour and Lipsky in consultation with Pepper drafted the terms of an offer for the syndicate to purchase Teleservice's shares at $15 per share. By his own admission, Pepper had hoped that a successful deal would yield him a commission from the "selling group", presumably the Teleservice shareholders. Shortly before the April 25 offer, he suggested that he might pressure his

client, Mrs. Arlinghaus, into acceptance by threatening that Ritenour and Lipsky would resign otherwise. The district court credited Ritenour's and Lipsky's testimony that they had flatly declined this invitation. Nevertheless, Mrs. Arlinghaus claimed, and Judge Werker found, that Pepper made such threats on numerous occasions, and, indeed, that rumors of their impending resignation circulated back to Ritenour and Lipsky. Although the record indicates that both Mrs. Arlinghaus and her brother-in-law, Clemens, learned that the syndicate or something like it existed, there is no suggestion that they knew the terms of its agreement with Ritenour and Lipsky or of the substantial interest of Ritenour and Lipsky in consummating the deal.

With one exception, Teleservice's

minority shareholders accepted the $15 offer. On May 10, 1967, Mrs. Arlinghaus met with Pepper, Clemens Arlinghaus, Ritenour and Lipsky to discuss the offer in a meeting, about which there was conflicting testimony at trial. Ritenour claimed that he had expressly denied rumors that he and Lipsky would resign if the syndicate deal failed; Mrs. Arlinghaus could recall no such denial; and Clemens asserted that, far from assuring loyalty, Ritenour and Lipsky had actually threatened resignation. The district court credited Ritenour's testimony, but thought that appellant might have mistaken the evidence enthusiasm of Ritenour and Lipsky for consummating the deal as an implicit threat to resign if it fell through. In any event, the meeting ended inconclusively and was immediately followed by a second

discussion among Mrs. Arlinghaus, Clemens, and Pepper, during which it was decided to make a counteroffer to sell to Ritenour and Lipsky at $20 per share. Appellant testified that but for the threats of resignation she would never have agreed to the $20 price. However, the district court discounted this claim in light of both Mrs. Arlinghaus' need to raise funds for the estate tax assessment and earlier discussion of the $20 figure as a desirable price to receive for the estate's share from the corporation.

The counteroffer was made and accepted, the remaining shareholders assented, and a closing was set for June 9, 1967. Given the terms of the syndicate's separate agreement to give Ritenour and Lipsky a 25% share of the corporation, the $20 offer to Teleser-

vice's shareholders represented an actual cost to the syndicate of $26.80 per share. As the closing approached, the syndicate scrambled to raise the necessary $1,182,000 ($1,176,000 for Teleservice's outstanding shares and $6,000 in bonuses for Ritenour and Lipsky). A June 6 telegram from Stat to Ritenour gave assurances that the funds were available, in part because Lehigh Valley Industries, a possible source of financing, would contribute its own stock on the basis of a future earnings formula that estimated Teleservice's total value "in excess of two million dollar[s]." There is little to substantiate Stat's account of the Lehigh Valley formula, since the syndicate ultimately failed to raise necessary funds by the day of the closing.

The failure of the syndicate deal

initiated a flurry of activity. On June 11 or 12, two days after the aborted closing, Ritenour met with John Stevenson, a friend and wealthy investor, to explore the possibility of financing the purchase of Teleservice shares at a $20 price and on terms similar to those offered by the syndicate. On June 14, the Teleservice board authorized Ritenour and Lipsky to retain a financial consultant to represent Teleservice in a sale of assets. With this mandate, Ritenour contacted Smith, Barney & Co., which, as Ritenour recalled, indicated a price "yardstick" for Teleservice assets of between five and twelve times earnings or from $14.88 to $35.70 per share.[5] In addition,

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[5] A formal representation agreement was concluded between Teleservice and Smith, Barney on July 25, 1967. Although the latter firm participated in at least two exploratory meetings with potential buyers, nothing seems to

(footnote continued)

beginning as early as June 9 and continuing through the following weeks, Ritenour and Lipsky began to explore the possibility of a direct purchase of Teleservice's stock -- a possibility that was the subject of several discussions with, inter alios, Pepper who expressed interest in becoming a participant in any deal that was afoot. These discussions culminated in a successful offer to Teleservice shareholders.

In the case of Mrs. Arlinghaus, the terms of the Ritenour-Lipsky-Pepper offer are contained in three letters drafted by Pepper. Two letters author-

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(footnote continued)

have developed from these discussions. During the same time frame, Ritenour met with several other possible buyers on his own including representatives of the Los Angeles Times and Lehigh Valley Industries. However, so far as the record shows, these meetings produced neither offers nor estimates of Teleservice's value.

ized the respective transfers of 4,000 shares of Teleservice, appellant's entire personal holdings, and 9,104 shares, or approximately 45% of her holdings as executrix of Frank Arlinghaus' estate, to Lipsky, Ritenour's wife, and Miriam Pepper at a total price of $10 per share -- $3 payable immediately and $7 payable within a year after transfer.[6] The third letter detailed the terms of the transaction including separate repurchase option agreements between appellant and Ritenour. These agreements provided that if Mrs. Arlinghaus failed to receive at least $20 per share for the 2,800 shares held in each of the custodian accounts for her three children within a year, Ritenour would re-

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[6] Only one of the two transfer letters drafted by Pepper was in evidence. After the letters were drafted, Ritenour's name was substituted for that of his wife as purchaser of Teleservice shares.

turn the 4,000 shares sold by appellant personally at the $10 sale price; and that if appellant failed to receive at least $31.64 per share for the estate's remaining holdings, the stock sold by the estate would be returned on the same terms. In short, Mrs. Arlinghaus was to sell 40% of the total Arlinghaus holdings at $10 per share on the condition that she would receive an average price of $27 per share for the stock remaining in the custodian and estate accounts.[7] She was thus assured of an

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[7] After the proposed sale, Mrs. Arlinghaus' holdings would comprise 11,256 shares in the estate's account and 8,400 shares in the custodian accounts. Thus, Mrs. Arlinghaus was assured an average price on these shares of [(11,256 x $31.64) + (8,400 x $20.00)] divided by (11,256 + 8,400), which equals $26.67 per share. The district court observed, at note 9, that

> [t]he very working of the sale agreement ... put plaintiff on notice that the defendants fully expected to arrange a sale of the stock at a minimum of $27 a share, more than twice the price offered [in the July, 1967 offer].

(footnote continued)

average price for her entire holdings of at least $20 per share -- the same price which she had proposed in the aborted syndicate transaction. Teleservice's minority shareholders (other than Ritenour and Lipsky) each received similar offers for 40% of their holdings. A separate understanding allotted 37.5% of the outstanding shares purchased to Ritenour, 37.5% to Lipsky, and 25% to Miriam Pepper.

Appellant's acceptance of the offer was manifested by her signed approval of the June 30 letters of agreement drafted by Pepper and by her written consent, dated July 26, 1967, to the

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(footnote continued)

In addition, appellant's work sheets indicate that she was well aware that she would obtain an average price of at least $20 per share for the entire Arlinghaus holdings including the shares sold to Ritenour, Lipsky, and Pepper.

release of these letter.[8] However, the basis for her decision is clouded by her testimonty that she "had in mind" the prospect of resignation by Ritenour and Lipsky if she refused; by the district court's finding that she acted in total reliance on Pepper; and by that court's finding that Ritenour and Lipsky failed to provide any assurance of loyalty after May 10.[9]

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8 The parties dispute the exact date on which the agreement with Mrs. Arlinghaus was consummated. Appellees point to the July 1 date on which Ritenour committed himself to the repurchase offer. Mrs. Arlinghaus points to yet another letter indicating Pepper's agreement not to release the letters of agreement containing her signed approval under after the other shareholders had accepted. At the latest, the agreement was concluded on July 26, when Mrs. Arlinghaus agreed in writing to the release of her approval. We accept the later date.

9 The record contains no evidence of specific instances of threats or rumors of threats after the May 10, 1967 meeting, see the description supra. However, Mrs. Arlinghaus testified that the threats from Pepper were continuous. Much less clear is whether Ritenour and Lipsky received fresh indications that Pepper's threats continued after the denial on May 10.

Following the in-house sale of 40% of Teleservice, the search for a sale or merger partner for the entire company continued unabated. On September 13, 1967, Screen Gems, a company that had previously negotiated with Ritenour, offered $1,500,000 in stock for Teleservice, with an additional maximum of $1,000,000 in stock payable over a five-year period if certain earnings requirements were met. Similarly, negotiations with another potential purchaser, Fuqua Industries, began as early as the last week of August, 1967, and culminated on November 17, when Fuqua offered roughly $3,000,000 of its own stock, equivalent in value to $51 for each share of Teleservice. Although this offer was accepted, Fuqua withdrew it shortly before the scheduled March 5, 1968 closing date upon learning

that Teleservice's earnings for the preceding year had failed to match Ritenour's forecast.[10] Ironically, however, Harris Shapiro, the organizer of the unsuccessful syndicate deal, stepped into the breach by arranging negotiations with yet another potential purchaser, the Sonderling Broadcasting Company.[11] On March 25, 1968, Sonderling agreed to purchase Teleservice in exchange for 130,000 of its shares, worth $29.75 each on the date of closing.

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[10] We do not know what the earnings or the forecasts were. Indeed the record is singularly barren of evidence of Teleservice's earnings beyond what is stated in note 3 supra, or why they turned out to be so highly prized.

[11] Shapiro had also been active on Teleservice's behalf while negotiations with Fuqua were in progress. In late fall of 1967, Shapiro placed Pepper in contact with Wometco, a potential purchaser that, according to Pepper, offered a yeardstick acquisition price of $2,000,000 providing that Teleservice's net income reached $200,000 for the year. As Fuqua's offer was considerably more generous, nothing came of the Wometco negotiations.

As Shapiro received 10,000 Sonderling shares for his brokerage fee, the Teleservice shareholders netted 120,000 shares of Sonderling -- an equivalent of $60.71 per share of Teleservice. Mrs. Arlinghaus obtained 22,971 shares of Sonderling for the 11,256 shares of Teleservice held by Frank Arlinghaus' estate and presumably obtained an additional 17,143 shares of Sonderling for the remaining Teleservice stock in her children's custodian accounts. Thus the average price that appellant obtained for the sale of her entire holdings including the earlier sale to Lipsky, Ritenour and Pepper, was $41.03 per share.

The Decision Below and the Appeal

The district court dismissed all claims against Ritenour and Lipsky after

concluding that they had never threatened Mrs. Arlinghaus with resignation; that they had made routine reports on all negotiations bearing on Teleservice's value to the directors and to Pepper as Mrs. Arlinghaus' attorney, and were under no further obligation to report to Mrs. Arlinghaus herself; and that they had not conspired with Pepper, either expressly or tacitly, to defraud Mrs. Arlinghaus and were therefore not liable for Pepper's actions. With respect to Pepper, by contrast, the court found liability for breach of fiduciary duty on two grounds; that he had intentionally misrepresented the prospects of Ritenour and Lipsky's resignation in order to encourage a sale and thereby acquire either a commission or an interest in Teleservice and that he had concealed from Mrs. Arlinghaus the fact that ne-

gotiations for the sale of [Teleservice] indicated a probable corporate value of two to three million dollars. Any such knowledge on Pepper's part could only have come from Ritenour and Lipsky.

As previously noted, Mrs. Arlinghaus settled her claims against Pepper while this appeal was pending. She now attacks the district court's dismissal of her claims against Ritenour and Lipsky, urging, first, that the district court erred in concluding that adequate disclosure to Pepper also constituted disclosure to Mrs. Arlinghaus; second, that Ritenour and Lipsky, as officers and directors of Teleservice, owed a duty of full disclosure of Teleservice's value to appellant under both the doctrine of Strong v. Repide, 213 U.S. 419 (1909) as incorporated in New

York law and § 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder; and, third, that Ritenour and Lipsky are jointly liable for Pepper's breach of his fiduciary duty to Mrs. Arlinghaus under New York law so long as they both knew of and benefitted from that breach.

Discussion

Insofar as the court's decision rested on the premise that disclosure by Ritenour and Lipsky of the value of Teleservice to Pepper constituted disclosure to Mrs. Arlinghaus, it was in error. Third party disclosure to an agent is not imputed to the principal when the agent is acting adversely to the principal's interest and the third party has notice of this, Restatement

(2d) Agency, § 271 (1958).[12] See Benedict v. Arnoux, 154 N.Y. 715, 727-30 (1898); Otsego Aviation Service, Inc. v. Glens Falls Ins. Co., 277 App. Div. 612, 102 N.Y.S.2d 344, 349 (3d Dep't 1951); Farr v. Newman, 14 N.Y.2d 183, 189-91, 250 N.Y.S.2d 272, 276-78 (1964); Otsego Mutual Fire Ins. Co. v. Darby, 79 Misc.2d 80, 84-96, 358 N.Y.S.2d 314, 318-19 (S.Ct. Fulton Co. 1974); 2 N.Y.Jur., Agency § 268 (1958). Thus, from the moment Ritenour and Lipsky learned of Pepper's self-interested scheming, they could no longer satisfy any disclosure obligations they might

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12 Restatement (2d) Agency, § 271 provides:

> A notification by or to a third person to or by an agent is not prevented from being notice to or by the principal because of the fact that the agent, when receiving or giving the notification, is acting adversely to the principal, unless the third person has notice of the agent's adverse purposes. [Emphasis added.]

have to Mrs. Arlinghaus merely through communications with Pepper. Of course, at some point during late June, 1967, Mrs. Arlinghaus herself learned of Pepper's interest in the July, 1967 sale, but continued to allow him to act as her agent. It is arguable, then, as the district court intimated, that Mrs. Arlinghaus would be estopped from asserting lack of disclosure for additional valuation developments made known to Pepper but not to her after she learned of his adverse interest. See Mittendorf v. Williston & Roane, Inc., 372 F. Supp. 821, 829 (S.D.N.Y. 1974). We need not decide this, however, in view of the district court's finding, see discussion infra, that the very terms of the in-house sale indicated the buyers' belief in July, 1967, that they could obtain at least $27 per Teleservice share and

our conclusion that there was no evidence that before then anyone had specific information of a higher value.

We also question whether, if Ritenour and Lipsky had had specific indications that the stock was worth more than the value attainable under the July, 1967 agreements, the district court would have been correct in concluding that a general disclosure to the board of directors that the stock was worth more, even giving weight to Clemens Arlinghaus' directorship, would have satisfied their obligations. This was a closely held corporation and the two top officials owed a special duty of disclosure to the widow of the founder and majority stockholder, violation of which would give rise to liability both under the doctrine of Strong v. Repide, supra, 213 U.S. 419, see 3 Loss,

Securities Regulations 1447-48 (1961), which appears to be the law of New York in the case of small, closely held corporations, see McManus v. Durant, 168 App. Div. 643, 660-64, 154 N.Y.S. 580, 592-94 (1st Dep't 1915); Saville v. Sweet, 235 App. Div. 236, 237-38, 254 N.Y.S. 768, 770-71 (1st Dep't 1932) (dictum), aff'd 262 N.Y. 567 (1933); contrast Fischer v. Guaranty Trust Co., 259 App. Div. 176, 18 N.Y.S.2d 328 (2d Dep't 1940), aff'd 285 N.Y. 679 (1941), and under Rule 10b-5, see Dupuy v. Dupuy, 551 F.2d 1005 (5 Cir. 1977) (Wisdom, J.), cert. denied, 434 U.S. 911 (1978). We need not decide this, however, since we find nothing in the record to show that prior to the July, 1967 agreements Ritenour and Lipsky had sufficient reason to believe that Teleservice could command a sales price substantially in

excess of $20 per share ($1,117,600 for the 58,800 shares), the price which Mrs. Arlinghaus proposed in the never consummated syndicate deal and which would have to be realized in order to prevent rescission of the in-house deal, see footnote 7 supra, to require direct disclosure to Mrs. Arlinghaus under the principles laid down in the cases just cited.

The facts have been set forth above and need not be repeated here. The Filmways discussions of late 1966 which were reported to the Teleservice board on December 12, 1966, produced a price range between $875,000 and $1,400,000 or $14.88 to $23.81 per share; $20 was slightly over the midpoint. We attach little significance to the $3,000,000 asking price possibly put forward by Ritenour to Ross and Screen Gems before

July, 1967; there is no indication that either Ross or Screen Gems manifested any interest in such a figure. Perhaps the strongest argument that Ritenour and Lipsky knew that the stock was worth significantly more than $20 per share was the agreement with the Stat syndicate, which, because of the secret deal with Ritenour and Lipsky, involved an effective price of $26.80 per share. However, as Mrs. Arlinghaus knew, that deal collapsed when the syndicate failed to obtain adequate financing. Equally important, Judge Werker found that the terms of the Ritenour-Lipsky-Pepper offer alerted Mrs. Arlinghaus to the fact that the buyers believed that they could obtain at least $27 per share of Teleservice, see note 7 supra. Thus the pricing information withheld during the syndicate negotiations was revealed,

at least in part, by the terms of the July, 1967 offer itself. Five days after the date set for the closing under the syndicate agreement, Teleservice's board was sufficiently uncertain about the price at which the company could be sold that it retained a well-known Wall Street firm to advise it. The firm's report attested the dubieties inherent in the sale of a relatively small service business by giving a range of from $14.88 to $35.70 per share. The $20 figure which was the real price under the Ritenour-Lipsky-Pepper offer, see note 7 supra, was not far below the midpoint of this range. The later offers have only remote evidentiary significance since we do not know what happened to Teleservice's earnings in the meanwhile. Apart from this, except

for the Sonderling offer some nine months after the July, 1967 agreements, these cannot bear the weight that appellant would place on them. Screen Gems' September 13, 1967 offer was $1,500,000, with the prospect of up to an additional $1,000,000 if certain earnings requirements were met, but there is no evidence what these requirements were, much less that they would have been met. Fuqua's November 17, 1967 offer of about $3,000,000 in stock is the first that would support the judge's conclusion that negotiations for the sale of Teleservice indicated "a probable corporate value of two to three million dollars", but this offer was withdrawn when Teleservice's earnings, whatever they were, failed to meet Ritenour's forecasts, whatever these may have been. Only by

assuming that something going at least part way toward Sonderling's March 25, 1968 offer seemed reasonably assured in July, 1967, could the judge's conclusion be justified, and we see no sufficient evidence of this. Although Ritenour and Lipsky may have hoped for such an offer in July, 1967, we find nothing in this history to suggest that they had learned any facts sufficiently indicative of Teleservice's true value, as later developed, to require them either under the common law of New York or under Rule 10b-5 to seek out Mrs. Arlinghaus and expressly advise her that Teleservice's value might far exceed the $20 per share she had been willing to accept from the syndicate and was assured of obtaining for her entire holdings under the July, 1967 agreements.

We have considered whether we may properly affirm on a ground of lack of knowledge by Ritenour and Lipsky as to the value of Teleservice which was not relied upon by the district court (indeed is contrary to one of its conclusions in finding liablity on the part of Pepper) and, what is more important, which was not pressed by Ritenour and Lipsky on appeal prior to this court's questioning at argument and later request for additional briefing. The fact that the judge's conclusion of a $2-3 million value known to Pepper in July, 1967, was not contested by appellees by a separate cross-appeal is no obstacle since, under the rule of Langnes v. Green, 282 U.S. 531 (1931), the judgment of a lower court may be affirmed without cross-appeal on the

basis of "any argument that is support by the record, whether it was ignored by the court below or flatly rejected." 9 Moore, Federal Practice ¶ 204.11[3], at 4-45 (2d ed. 1980) (footnote omitted). See Dandridge v. Williams, 397 U.S. 471, 475-76 & n.6 (1970). To be sure, the Langnes rules is subject to certain limitations including the well-established bar against theories advanced by appellees without a cross-appeal which challenge some aspect of the lower court's judgment. See 9 Moore, Federal Practice, supra, ¶ 204.11[3],[4]. We thus might question the propriety of rejecting the valuation finding were this to unsettle any portion of the district court's judgment, including the resolution of claims against Pepper. See generally Stern, When to Cross-Ap-

peal or Cross-Petition -- Certainty or Confusion?, 87 Harv. L. Rev. 763 (1974) (exceptions to the Langnes rule). Even with respect to Pepper, however, our rejection of the valuation finding leaves the district court's judgment intact. The first and principal ground for Pepper's liability was the district court's determination that he had breached his fiduciary obligations as counsel to Mrs. Arlinghaus and her husband's estate by falsely representing that Ritenour and Lipsky threatened to resign if they could not acquire a substantial interest in Teleservice. This determination finds ample confirmation in the record, and would support the judgment against Pepper regardless of the valuation finding or the larger question whether the Ritenour-Lipsky-Pepper pur-

chase was made with adequate disclosure to Mrs. Arlinghaus.[13] In any event, the judgment against Pepper now stands inviolate as a result of the settlement between his estate and Mrs. Arlinghaus.

The issue thus narrows to whether the failure of Ritenour and Lipsky to attack the $2-3 million valuation in this court prior to our raising the point at oral argument should bar a decision resting on a rejection of the district court's conclusion on that score. As indicated above, an appellate

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[13] Pepper was bound by a higher standard of fiduciary duty than Ritenour and Lipsky. New York Law imposes the highest level of fiduciary duty on all aspects of an attorney's dealings with his client. See Whitehead v. Kennedy, 69 N.Y. 462, 466 (1877) (attorney dealing with client must make "reasonable use" of client's confidence; the client must have "full knowledge of all material circumstances known to the attorney" and be "free from misconception"). See also 3 N.Y. Jur., Attorney-Client §§ 68, 69 (1958).

court may consider any argument or theory that finds support in the record and will serve to sustain a correct lower court decision. See, e.g., Helvering v. Gowran, 302 U.S. 238, 245-46 (1947). Although authority is sparse, this rule obtains even when the appellate court raises the decisive theory sua sponte. See Cold Metal Process Co. v. McLouth Steel Corp., 126 F.2d 185, 189 (6 Cir. 1942) (dictum); cf. City of Vero Beach v. Rittenoure Inv. Co., 113 F.2d 269, 272 (10 Cir. 1940) (recent change in law raised sua sponte). To be sure, appellate courts must tread cautiously over terrain that the parties have failed to explore on appeal. Any issue injected into the appeal by the court itself must have been adequately presented below, and the parties must have had a full oppor-

tunity to develop the relevant facts. See Heirs of Fruge v. Blood Services, 506 F.2d 841, 844 n.2 (5 Cir. 1975). In addition, the appellate court should have the benefit of thorough briefing before considering a decisive issue or rationale. See Paskaly v. Seale, 506 F.2d 1209, 1211 n.4 (9 Cir. 1974). In this case, however, all three conditions were met. Ritenour and Lipsky heatedly denied advance knowledge of Teleservice's market value in their post-trial brief to the district court; the same question had been among the principal subjects of deposition and trial testimony; and this court's invitation to submit supplemental briefs has provided Mrs. Arlinghaus ample opportunity to canvass the record in order to support the conclusion that

the defendants had learned of a probable $2-3 million sale price before the end of July, 1967.[14]

Appellant counters that if this court rejects the district court's valuation conclusion sua sponte, she will have been denied the opportunity to have raised in her reply brief or her first supplemental brief additional theories of liability that she would have advanced if appellees had challenged the valuation conclusion in theirs. Even if appellant was entitled so to reserve a point, which may be doubtful, see 9 Moore, Federal Practice, ¶ 228.02[2.-1]

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[14] Appellees' failure to challenge the $2-3 million valuation on appeal is rendered somewhat more comprehensible, though no less regrettable, by the tentative phrasing of that conclusion, its placement among the district court's conclusions of law rather than findings of fact, and its restricted function in the district court's opinion as an alternative ground for establishing Pepper's liability.

(1980 ed.), citing Mississippi River Corp. v. F.T.C., 454 F.2d 1083, 1093 (8 Cir. 1972), fairness requires no more in this case than that we accord full consideration to the one theory that Mrs. Arlinghaus claims to have excluded from her briefs as a result of appellee's failure to attack the valuation conclusion, namely, the argument that Ritenour and Lipsky are liable for all of Pepper's actions as fellow participants in a conspiracy to obtain Mrs. Arlinghaus' shares of Teleservice through fraud, coercion and breach of fiduciary duty.[15]

As developed in appellant's post-

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[15] In addition to the supplemental briefs which we requested both sides to file after the argument, counsel for Mrs. Arlinghaus filed a "reply to appellees' second supplemental brief". The brief does not develop the conspiracy theory, although this had been done in appellant's post-trial brief in the district court, which we have also examined.

trial brief below, the existence of the alleged conspiracy is said to rest on the joint participation of Pepper, Ritenour and Lipsky in the 40% purchase from Mrs. Arlinghaus; on their joint participation in drafting both the syndicate and 40% purchase offers; on Ritenour's and Lipsky's knowledge of Pepper's willingness to use coercive tactics; on Ritenour's and Lipsky's failure to reassure Mrs. Arlinghaus of their loyalty prior to the 40% purchase offer; and on Pepper's manifest desire to profit, either by a commission or by direct participation, from any successful purchase of the Arlinghaus stock. From these facts, appellant urges the inference of an explicit or tacit agreement that Pepper was to be rewarded for persuading appellant to sell to Ritenour

and Lipsky. The district court rejected this claim in light of its findings that appellees had instructed Pepper not to threaten their resignation and had expressly denied such threats to Mrs. Arlinghaus at the May 10 meeting. On the record before us, we cannot disagree.

Under New York law, a defendant may be held liable in tort for conspiracy "to do an unlawful thing, or to do a lawful thing in an unlawful manner," 8 N.Y. Jur., Conspiracy § 1, at 494 (1959). See, e.g., Triple D & E, Inc. v. Van Buren, 72 Misc. 2d 569, 573-74, 339 N.Y.S.2d 821, 827 (Sup. Ct. Nassau Co. 1972), aff'd, 42 App. Div. 2d 841, 344 N.Y.S.2d 378 (1973). Given our determination that despite Pepper's delicts, the 40% purchase would not have been

fraudulent if accomplished by Ritenour and Lipsky alone, the claim must be that appellees conspired with Pepper either to pursue the 40% purchase by unlawful means or to aid Pepper in the breach of his fiduciary obligations. The district court's findings present an insuperable obstacle to both theories. On the most generous reading of the record compatible with those findings, the basis for charging Ritenour and Lipsky would have to be that, despite their May 10 repudiation of resignation threats, they acquiesced in Pepper's continuing assertions of such threats, which they learned of indirectly through the unabated flow of rumors. But such behavior, even if badly motivated, hardly establishes a conspiracy absent "intentional participation with a view to

furtherance of the common design," Bedard v. LaBier, 20 Misc.2d 614, 617, 194 N.Y.S.2d 216, 220 (Sup. Ct. Clinton Co. 1959). Not only is evidence of a common design lacking here, but as Ritenour's trial testimony suggested and the district court found, appellees were initially cool to Pepper's participation in the in-house purchase. Even if a common design were imputed, however, acquiescence fails to rise to the level of participation at least without an affirmative duty to act. The court found that in April, 1967, Ritenour and Lipsky had instructed Pepper not to assert threats on their parts and had emphatically denied these threats at the May 10 meeting. They were under no obligation to volunteer repeated reassurances even if they knew Pepper

was repeating the threats, and, in the light of Mrs. Arlinghaus' view of their intentions, such reassurances would have been unlikely to be effective in any event.

This is a close and has been a troubling case. In affirming we bestow no medals of honor on Ritenour and Lipsky. Although their desire to have a stake in the enterprise is understandable, they were not entitled to pursue that goal by means that were unfair to Mrs. Arlinghaus. In particular we do not condone their conduct in concealing the secret side agreement under which the syndicate would have given them 25% of the corporation, thereby bringing to $26.80 the true price to be paid by the purchasers rather than the $20 per share offered the stockholders, and

under which they were to receive cash bonuses for driving the price down. If the syndicate purchase had closed, Mrs. Arlinghaus might well have been able to rescind it. However, accepting, as we do, the judge's version that Riteneour and Lipsky repudiated Pepper's stories of their threats to resign and finding no sufficient evidence that prior to July 26, 1967, they had any such knowledge of a realizable price for Teleservice in excess of $20 per share as to require direct communication to Mrs. Arlinghaus, we are constrained to affirm.

It is so ordered. No costs.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ROSALIE M. ARLINGHAUS, Executrix of the Will of FRANK H. ARLINGHAUS, and ROSALIE M. ARLINGHAUS, individually, Plaintiffs,

-against-

J. RICHMOND RITENOUR, JOHN J. LIPSKY, MIRIAM PEPPER and SIDNEY PEPPER, Defendants.

68 Civ. 3537 (HFW)

Filed August 28, 1975

OPINION

HENRY F. WERKER, D. J.

This is an action for fraud, duress and breach of fiduciary duty in the defendants' purchase from plaintiff of stock in Modern Teleservice, Inc. (hereinafter "MTS"), a now-defunct closed corporation engaged in the distribution of television commercials. Plaintiff is a former physical therapist whose husband, Frank Arlinghaus, incorporated

MTS in 1956, retaining a controlling share of the corporation's stock until his death in 1964. The stock at that time passed to plaintiff and to his estate, of which plaintiff was executrix. The defendants J. Richmond Ritenour and John J. Lipsky are former executrix officers of MTS who, with Frank Arlinghaus, established and ran the corporation between 1956 and 1968. Defendant Sidney Pepper is the former legal counsel to MTS, as well as former counsel to plaintiff. Miriam Pepper is his wife.

The suit arises from plaintiff's sale of MTS stock to Messrs. Ritenour and Lipsky, and Mrs. Pepper in June of 1967. Approximately one year after this sale plaintiff instituted the present action for rescission, or in the alternative, for compensatory and punitive damages. She asserts a variety of claims

against the defendants, over which this court has federal subject matter, diversity and pendent jurisdiction. 28 U.S.C. §§ 1331-1332; 15 U.S.C. § 78a(a). After trial without a jury the court has made the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. While MTS was in existence, J. Richmond Ritenour (hereinafter "Ritenour") served as President and Chief Executive Officer, John J. Lipsky (hereinafter "Lipsky") as Vice President, Frank Arlinghaus as Chairman of the Board, and his brother, Clemens G. Arlinghaus (hereinafter "Clem") as a member of the board of directors. The New York law firm of Dewitt, Pepper & Howell, of which Sidney Pepper (hereinafter "Pepper") was a partner, both served on retainer as corporate counsel to

MTS, and acted as attorney for Frank Arlinghaus, his wife, and his estate. Following Dewitt's death in 1965, Pepper was the only remaining resident partner of the firm.

2. Management and direction of the corporation were handled by Ritenour and Lipsky. As a result of their work with and for the corporation Frank Arlinghaus in 1960 offered to sell all its stock to them for $275,000. They were not able to obtain the necessary financing until 1961; by that time the asking price had increased beyond their resources. Ritenour and Lipsky were able, however, to purchase small lots of stock for approximately seven dollars a share.

3. When Frank Arlinghaus died his estate faced a large tax assessment with little in the way of cash available

to pay it. In an attempt to lower the valuation placed on the estate's MTS stock, Pepper filed with the IRS an affidavit dated October 27, 1966 which stated in pertinent part:

> The personal friendships of the president have been largely responsible for the retention of its [MTS's] business. The thought of what would happen if his services were no longer available to the corporation has troubled the estate.... The corporation has no contract for his services and cannot get one.

(Exhibit C). He suggested that an appropriate valuation would be $3.75 a share. The IRS, however, valued the stock at $9.53 a share.

4. In late 1967 plaintiff, her brother-in-law Clem, and Pepper had several meetings in which they considered whether to sell all or part of the estate's stock holdings in order to meet the IRS assessment. Under a voting

trust agreement executed by all the shareholders in 1956, as amended in 1959, 1962 and 1966, the estate would require MTS to buy back the stock at a formula price per share. Plaintiff, Clem and Pepper agreed at the first meeting that if the formula price were $20 or more, it "might be desirable" to put the stock to the corporation (Tr. 42). The formula price, however, was later determined to be only $16 a share.

5. At a board of directors meeting in 1966 the company authorized Ritenour and Lipsky to look for a merger partner or purchaser for MTS. At approximately the same time these two officers realized that the Arlinghaus estate would not put its stock to the corporation and thereby make it available for them to purchase. Because they still wanted to increase their equity in MTS,

they sought to arrange an MTS purchase or merger that would satisfy both their desire and that of the corporation. Several exploratory meetings were held with brokers. Ritenour routinely reported the fact and results of such meetings to the board of directors and to Pepper, as counsel to the corporation and to the corporation's majority stockholders.

6. By April 1967 Ritenour and Lipsky had produced a syndicate of investors willing to finance their acquisition of all MTS stock at $15 a share with the understanding that a Delaware corporation would then be formed to merge with MTS. Ritenour and Lipsky were to receive 25% of the stock of the post-merger company, as well as a brokerage fee for obtaining MTS for the syndicate.

7. On April 25, 1967 Ritenour and Lipsky drafted an offer to all MTS share-

holders to purchase their stock at $15 a share. No mention was made of the syndicate in the letter. Before the letter was sent out the offer was discussed with Pepper who reviewed and approved its wording. Pepper, therefore, knew of the syndicate, although he may not have known all the details of the brokerage arrangement. Indeed, he hoped to receive an agent's fee from the parties for effecting the transaction (Tr. 152).

8. After reviewing the offer language, Pepper asked Ritenour and Lipsky if he could improve the chances of completing the purchase by threatening the stockholders with their resignation should the offer not be accepted. Ritenour and Lipsky emphatically rejected this suggestion. They did subsequently hear, however, that such rumors were circulating.

9. After the offer had been received by the stockholders Pepper told plaintiff numerous times that Ritenour and Lipsky had threatened that if she did not sell to them they would resign. Pepper suggested to plaintiff that if they did so, they would take the corporate accounts, leaving her and the corporation with nothing but "wallpaper and film-winding machines." (Tr. 230). He did not tell her of the syndicate, although in speaking with Clem he stated that Ritenour and Lipsky were serious in their desire to purchase and had "adequate backing" to do so (Tr. 49). On May 10, 1967 plaintiff, Pepper, Clem, Ritenour and Lipsky met over lunch at the Rockefeller Center Rainbow Room to discuss the offer. The testimony differs as to what, if anything, was said with regard to resignation. Plaintiff

testified that nothing was said at this luncheon to dispel the threat of resignation conveyed to her by Pepper, but admits that she did not specifically ask the two officers about it. Ritenour and Lipsky testified that Ritenour denied rumors to that effect to plaintiff's face. Pepper recalled no talk of resignation. Clem testified that the two men repeated their threat; in light of plaintiff's testimony that neither Ritenour nor Lipsky ever personally told her they would resign, Clem's account of the luncheon conversation is not credible.

Having had the opportunity to observe all the witnesses on the stand, the court finds Ritenour's account of the discussion to be the most credible. His account, furthermore, is not necessarily inconsistent with that of plain-

tiff. All witnesses agree that the thrust of the conversation was Ritenour and Lipsky's eagerness to acquire MTS. Because of Pepper's prior comments, plaintiff may have taken their eagerness to combine MTS business control and ownership as an indication that they would seek such a combination elsewhere if necessary. Plaintiff, in any case, failed to question them on this point or seek clarification of what Pepper had told her.

10. Following that luncheon plaintiff, Clem and Pepper conferred and decided to propose a $20 a share counteroffer. In considering whether to sell, and at what price, plaintiff never investigated the net worth of the corporation nor sought an outside appraisal. Unsophisticated in stock transactions, she relied heavily on her attorney

Pepper, and to a lesser extent, on her brother-in-law Clem.

Plaintiff has testified that she never would have agreed to the $20 sale had she not been coerced by the threat of resignation. However, in light of her need to raise cash for the estate,[1] and her earlier determination that a put at $20 might be desirable, the court lends little credence to this assertion. Plaintiff also alleges that she was not told of the existence of the syndicate, and thought the sale one directly to Ritenour and Lipsky. Plaintiff's May 12, 1967 letter to Pepper, however,

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[1] In December of 1966 plaintiff had been advised by Pepper that in order to meet the IRS assessment "the sale of stock is undoubtedly called for in the near future" (Exhibit D, p. 4). Similarly Clem felt that such a sale was necessary to pay the estate tax (Tr. 89). Lastly, plaintiff wrote to Ritenour on May 15, 1967, in contemplation of the $20 sale, authorizing payment of $80,000 of the money due her to Pepper's firm for use in satisfying the IRS lien (Exhibit B).

belies this allegation; it states in pertinent part: "I am willing to transfer to a purchaser or purchasers designated by them [Ritenour and Lipsky] ... all the shares of stock ..." (Exhibit 2).

Although the $20 counter-offer proved agreeable to all concerned, and a closing was scheduled for June 9, 1967, the syndicate failed at the last minute to provide Ritenour and Lipsky with the necessary financing and the sale was never consummated.

11. Still determined to increase their holdings of MTS stock, Ritenour and Lipsky discussed with Pepper as attorney for the corporation and for plaintiff a plan whereby the two officers with their own money would purchase 30% of each shareholder's stock. Pepper requested that as part of the plan he

be allowed to purchase stock as well. Although Ritenour and Lipsky were cool to the idea of Pepper buying into "their" company, they knew that the stockholders had a right to sell to anyone. They made it clear to Pepper that they intended to purchase 30% of the stock; what he arranged was his business. Pepper thereafter drafted a proposal for the stockholders' sale of 40% of their MTS holdings (30% to Ritenour and Lipsky, 10% to Pepper's wife[2]) at $10 a share,

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2 With respect to his wife's acquisition of MTS stock Pepper testified on direct examination as follows:

> Q. How did you happen to put the stock you acquired ... into Mrs. Pepper's name instead of your own?
>
> A. Well, I personally had had a coronary, and I was in anything but the best of health.
>
> It didn't seem sensible to me, with my tax background, to add to my so-called estate, so I preferred to give her the opportunity to make the investment, assuming that she would outlast me. That way, we could save a

with the understanding that the corporate officers would attempt to effect a sale or merger of MTS within a year that would yield the stockholders an average price of at least $20 a share for their entire original holdings;[3] failing such a sale, the stockholders would have the option of repurchasing their stock at the $10 price.

12. Without consulting Clem, and in total reliance on Pepper, plaintiff agreed to the $10 offer, her acceptance being conditioned on acceptance by the other shareholders as well. To make up the 40% she chose to pool all of her

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(footnote continued)

> Federal Estate Tax on the property passing from my estate to her.
>
> (TR. 405-06).

[3] To average $20 a share pursuant to this plan plaintiff needed to receive approximately $27 a share for the remaining MTS stock in her possession.

personal stockholdings with some of the estate's shares; the agreement of sale is evidenced by four letters dated June 30, 1967. Plaintiff alleges that she would not have entered into the sale but for the threat of Ritenour and Lipsky's resignations, which continued to be rumored to her by Pepper. Ritenour testified that at the time he felt these continuing rumors "had to come from Pepper." (Tr. 108). Neither he nor Lipsky, however, contacted plaintiff to set the record straight, or requested that Pepper do so.

13. In the fall of 1967 MTS and Fuqua Industries, Inc. entered into an agreement whereby Fuqua would acquire all of the MTS assets in exchange for Fuqua stock. Ritenour at the time calculated that the agreement was worth approximately $3 million to MTS stock-

holders, or approximately $55 a share. The exchange was predicated, however, on MTS showing a rate of earnings for 1967 that it did not achieve. The Fuqua deal, as a result, was never consummated.

14. During negotiations with Fuqua another corporation, Sonderling Broadcasting Corp., had expressed interest in MTS. When the Fuqua contract failed, a similar agreement was executed through a broker with Sonderling. This sale closed on April 8, 1968; plaintiff received 29,971 shares of Sonderling stock, worth $29.75 each for the account of her husband's estate.

15. On June 7, 1968 in connection with a similar sale of Modern Talking Picture Service, Inc., (hereinafter "MTPS") a MTS sister corporation in which plaintiff held shares and for which Pepper also acted as counsel, the

shareholders and Pepper executed an agreement to exchange mutual releases. The defendants to this action asserted affirmative defenses based on this agreement, which was subsequently challenged as unenforceable by the MTPS stockholders in a federal district court case before the Honorable Marvin E. Frankel. At trial before this court the parties agreed to be bound by Judge Frankel's decision. That decision, which was issued August 6, 1975, voids the release agreement. See First National Bank of Cincinnati v. Sidney Pepper, 68 Civ. 4570, S.D.N.Y.

CONCLUSIONS OF LAW

Plaintiff's complaint sets forth five claims which may be summarized as follows:

First Claim: Ritenour and Lipsky threatened her that they would resign

unless she sold stock to them. Pepper aided them in that he repeated the threat to plaintiff, suggested that such resignation would seriously impair the corporation's business, advised her that she had no choice but to sell, and failed to tell her she had legal remedies against them.

Second Claim: Ritenour and Lipsky breached their fiduciary duties as controlling corporate officers in that when purchasing her stock they maliciously concealed from her the true value of MTS and the fact that lucrative offers had been made to purchase the company. This information was known to Pepper as well.

Third Claim: Pepper breached his fiduciary duty to plaintiff in giving her the counsel alleged in the First Claim and in concealing the information

described in the Second Claim.

Fourth Claim: Ritenour, Lipsky and Pepper conspired to defraud plaintiff. Their acts as alleged in the first three claims constitute overt acts in futherance of the conspiracy.

Fifth Claim: In doing the above-described acts the defendants violated § 10-b of the Securities Exchange Act of 1934.

1. As the court finds that Ritenour and Lipsky never threatened plaintiff with resignation, either directly or indirectly, they are not liable to plaintiff on her First Claim; they specifically instructed Pepper not to spread rumors of resignation, and more importantly, specifically denied the truth of such rumors to plaintiff's face. No more can be required of them. As the allegations of the First Claim

against Pepper are reiterated in the Third Claim, they will be dealt with below.

2. Ritenour and Lipsky are not liable to plaintiff on her Second Claim because, as noted in the findings of fact, rather than conceal information on negotiations for the purchase of MTS, and the possible worth of the company to its shareholders, they made routine reports on such matters to Pepper, as attorney for the corporation, and as attorney for plaintiff. They had no duty to repeat to plaintiff information they could reasonably assume would be imparted to her by her attorney. Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967). Pepper's knowledge was imputable to plaintiff, for knowledge of the value of the corporation was well within the scope of his agency. Furthermore, once

the $10 offer had been made, plaintiff was on notice that her attorney was also acting for a party on the other side of the transaction;

> the rule of law is clear that where special facts warrant the inference, as here, that the principal knows that his agent is also acting for the party adversely interested in the transaction, and yet consents to let him act as his agent, the principal is estopped from denying notice and knowledge which the agent had during the negotiation.

Mittendorf v. Williston & Beane, Inc., 372 F. Supp. 821, 829 (S.D.N.Y. 1974).

3. Pepper is liable to plaintiff for breach of fiduciary duty on both parts of her Third Claim. With respect to the first part Pepper's attorney argues that Pepper did nothing more than repeat the opinion that had been set forth in his affidavit to the IRS. (See page 3, supra). The court has found, however, that Pepper both knowingly and

intentionally misrepresented Ritenour and Lipsky's position to plaintiff with a view towards effecting the sale, and thereby acquiring an agent's fee and/or an interest in the corporation.

Pepper's attorney also asserts that even if they are viewed as misrepresentations rather than opinions, Pepper's comments to plaintiff about Ritenour and Lipsky's resignation concerned future expectations and therefore are not actionable. The New York rule[4] is that an alleged fraudulent representation is not actionable if it relates merely to future expectations:

> [I]t must relate to a past or existing fact or something equivalent thereto, as distinguished from a mere estimate or expression of opinion.

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[4] The court has only pendent jurisdiction of this common law claim against Pepper (See United States Mine Workers v. Gibbs, 383 U.S. 715, 725 (1966)) and therefore will apply the law of the forum state in considering the legal issues raised.

National State Bank of Newark v. Flatbush Coin-O-Wash, Inc., 236 N.Y.S.2d 636, 637-38 (S. Ct. Kings 1963). However, the representation Pepper made was not that the two officers could, would or might resign, but that they had threatened to resign. That is a misrepresentation as to a past or existing fact.

Pepper is likewise liable to plaintiff for concealing from her the fact that negotiations for the sale of MTS indicated a probably corporate value of two to three million dollars. "A client is entitled to all the information helpful to his cause within his attorney's command." Spector v. Mermelstein, 361 F. Supp. 30, 39 (S.D.N.Y. 1972), aff'd in relevant part, 485 F.2d 474 (2d Cir. 1973). Particularly where an attorney seeks to benefit from a contract made

with his client, as Pepper did here,[5] he must "bend over backwards" to give the client every relevant fact as it becomes known to him, to inform him of all his rights and to completely disclose any disadvantage under which the transaction places the client along with the corresponding advantage that thereby accrues to the attorney. See Whitehead v. Kennedy, 69 N.Y. 462, 466 (1877); Reinhardt v. Smith, 17 N.Y.S.2d 77, 78 (S. Ct. Queens 1939). The burden of proof in this regard is on the attorney (60 Columbia St., Inc. v. Leofreed Real-

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5 As Pepper's direct testimony quoted above at note 2 indicates, he himself viewed the purchase of stock in his wife's name as a sale to him. Use of her name was a mere formality chosen for estate tax purposes. In any case "a fiduciary who arranges a transaction in breach of his fiduciary obligations does not free himself of the resulting personal liability therefore by so arranging it that the money paid thereon is routed directly to others instead of having it pass through his hands." Gerdes v. Reynolds, 28 N.Y.S.2d 662, 661 (S. Ct. N.Y. Cnty 1941).

ty Corp., et al., 110 N.Y.S.2d 417, 422 (S. Ct. N.Y. Cnty 1952); aff'd, 120 N.Y.S.2d 925 (App. Div., 1st Dept. 1953), and Pepper has failed to sustain this burden.

4. None of the defendants is liable to plaintiff on her Fourth Claim.

> Standing alone thoughts, ideas, plans, schemes or intentions do not constitute any actionable civil wrong. Rather it is the performance of an act, either tortious in itself or accomplished by wrongful means, by one or more persons pursuant to an agreement between two or more individuals which gives rise to civil liability.

Smith v. Helbraun, 238 N.Y.S.2d 212, 218-19 (S. Ct. Westchester 1963) (emphasis added). As plaintiff has failed to introduce convincing evidence of any agreement, express or implied, to defraud her in either her individual capacity or as executrix for her husband's estate, she may not recover on this

claim.[6]

5. Ritenour and Lipsky are not liable to plaintiff on her Fifth Claim. Section 10-b of the Securities Exchange Act prohibits the use, in connection with a sale or purchase of securities, of any manipulative or deceptive device.[7]

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[6] Plaintiff would have the court infer an agreement to defraud from the fact that Ritenour and Lipsky failed to contact her again after the Rainbow Room luncheon to deny the continuing rumors that they had threatened to resign, or to report to her that Pepper had "created" the threat out of thin air. The court finds however that no such agreement was entered into even sub silentio by the defendants to this action. In resting on their previous denial the officers were not seeking to aid Pepper in any scheme to defraud his client. In instructing Pepper not to make such threats and in specifically denying the threat at the Rainbow Room luncheon Ritenour and Lipsky satisfied their duty to plaintiff.

[7] Rule 10-b-5 defines manipulative and deceptive devices; it states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of a national securities exchange,
>
> (1) to employ any device, scheme or artifice to defraud,

(footnote continued)

As noted above, neither Ritenour nor Lipsky ever threatened plaintiff with resignation or agreed with Pepper that he should do so to induce a sale of stock.[8] Furthermore, in purchasing plaintiff's stock, they made a full disclosure of all material facts to her

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(footnote continued)

> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.
>
> 17 C.F.R. § 240.10-b-5 (1974).

8 Ritenour and Lipsky in any case had a right to resign from the corporation so long as they gave its directors and shareholders the notice needed to elect replacement officers. See The American Bluefriesveem, Inc. v. Heidl, et al., 35 Civ. 756 S.D.N.Y. 1946, at 38. Therefore even had they threatened to resign, this would not under New York law constitute duress. See Bachorik v. Allied Control Co., 34 A.D.2d 940, 312 N.Y.S.2d 272 (1st Dept. 1970).

agent, Pepper. Since the court has found no convincing evidence of a conspiracy or common scheme to defraud, Pepper's acts or omissions are not attributable to Ritenour and Lipsky.

6. Pepper is not liable to plaintiff on her Fifth Claim. She has, in essence, alleged two distinct causes of action against Pepper based on Rule 10-b-5. The first is that he knowingly misrepresented that Ritenour and Lipsky had threatened to resign. This cause of action must be dismissed because plaintiff has failed to prove reliance, i.e., she has failed to convince the court that this misrepresentation was "a substantial factor" in determining her course of conduct. List v. Fashion Park, 340 F.2d 457, 462 (2d Cir.), cert. denied sub nom., List v. Lerner, 382 U.S. 811 (1965).

The second such cause of action is that in failing to inform her of negotiations for the sale of MTS and the range of offering prices therein discussed, he omitted "a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." Rule 10-b-5(2), 17 C.F.R. § 240.10-b-5 (1974). The statements, of course, which Pepper made were those advising, as her attorney, that it would be in her best interest to accept the $15 and then the $10 offer. As noted above, and as plaintiff's counsel freely admits, however, plaintiff never sought an appraisal of the value of the corporation. Indeed, before accepting the $10 offer; which put her on notice that Pepper was acting for both sides in the transaction, she never even consulted

her brother-in-law who was on the board of directors and as such, was in a position to fairly estimate the sale value of the corporation.[9]

In the court's view, therefore, plaintiff has failed to demonstrate the due diligence expected of a majority stockholder who seeks to recover damages based upon alleged 10-b-5 violations. Cf. City National Bank v. Vanderboom, 422 F.2d 221, 230 (8th Cir. 1970); Jackson v. Oppenheim, CCH 1970-71 Transfer Binder ¶ 93,008 (S.D.N.Y. 1971). Plaintiff had a duty to exercise an informed judgment when confronted with defendants' offer.

> Hindsight reaction to an improvident sale by an insider to a stranger or even another insider,

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[9] The very wording of the sale agreement, furthermore, put plaintiff on notice that the defendants fully expected to be able to arrange a sale of the stock at a minimum of $27 a share, more than twice the price offered.

> based upon nondisclosed facts equally known or available to both parties ordinarily would not be considered within the protective basis of Rule 10-b-5....

Myzel v. Fields, 386 F.2d, supra at 736. See also Shappirio v. Goldbert, 192 U.S. 232, 241-42 (1904).

7. Plaintiff has proved no cause of action against Miriam Pepper. The case is accordingly dismissed with prejudice as to her.

8. In accordance with the stipulation of the parties at trial, the affirmative defenses based upon the release agreement voided by Judge Frankel are dismissed.

DAMAGES

Because plaintiff has not demonstrated reliance on Pepper's misrepresentations of resignation, or due diligence in investigating the worth of MTS, Pepper will not be held liable for the

profits which Ritenour and Lipsky received on the sale of her stock. However, in purchasing stock in his wife's name as detailed above, Pepper himself derived an unconscionable profit in violation of his fiduciary duties to plaintiff which he is not entitled to retain. He will therefore be held liable for the profits which his wife received, and is hereby ordered to account to plaintiff for those profits.[10] The case

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[10] In her complaint plaintiff seeks in the alternative recission of the sale to Mrs. Pepper and a declaration that she holds for plaintiff's benefit the shares of Sonderling Broadcasting Corporation stock received by her in exchange for the MTS stock purchased from plaintiff, or compensatory damages in the amount of the value of such stock with interest from June 30, 1967. However, in her post-trial brief she states:

> Defendants ... must account to plaintiff as constructive trustees. Plaintiff has the choice, however, to hold defendants liable in damages, instead. (cite) ... Plaintiff wishes to proceed against ... Miriam Pepper for an accounting....

Plaintiff's Post-Trial Brief at 57.

will be referred to a Magistrate for that purpose.

The court likewise awards plaintiff punitive damages for Pepper's breaches of fiduciary duty. New York courts countenance the award of such damages where, as here, the wrongdoer has acted maliciously or with a recklessness that betokens improper motive. Douglas v. Tomkins Realty Corp., 210 N.Y.S.2d 550, 552 (S. Ct. Bronx 1960). The policy behind the award of punitive damages in actions for breach of fiduciary duty has been eloquently detailed by Chief Judge (now Justice) Berger:

> [O]nce it has been shown that one trained and experienced holds himself out to the public as worthy to be trusted for hire to perform services for others, and those so invited do place their trust and confidence, and that trust is intentionally and consciously disregarded, and exploited for unwarranted gain, community protection, as well as that of the victim, warrants the imposition of punitive dam-

> ages. This is particularly true in areas of conduct where the acts committed, while reprehensible, may fall short of rendering the wrongdoer subject to criminal prosecutions. When one is commissioned by, or holds himself out to, the community to perform special services which may be engaged in for hire by others in the conduct of their personal or business affairs, such as lawyers, trust companies, realtors, or the like, such persons inescapably assume certain fiduciary responsibilities. The community in turn has a broad public interest, as a matter of public policy, in how such persons conduct their relations * * * In this case we express the broad public policy by the imposition of punitive damages. Punitive damages are particularly apt in such circumstances because they both punish the wrongdoer, and offer the wronged a greater incentive to bring derelicts to justice....

Brown v. Coates, 253 F.2d 36, 40 (D.C. Cir. 1958). In Coates the defendant lawyer and real estate broker entered into a contractual agreement with plaintiffs whereby he defrauded them of $7,000. The Court of Appeals upheld an

award of $7,500 in punitive damages in addition to that of $7,000 in compensatory damages. In this case the court chooses to limit the award of punitive damages to the same amount plaintiff wins as compensatory damages upon Pepper's accounting.

SO ORDERED.

Dated: New York, New York
August 27, 1975

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U. S. D. J.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ROSALIE M. ARLINGHAUS, Executrix of the Will of Frank H. Arlinghaus, individually,

Plaintiffs,

-against-

J. RICHMOND RITENOUR, JOHN J. LIPSKY, MIRIAM PEPPER and SIDNEY PEPPER,

Defendants.

68 Civ. 3537 (HFW)

Filed October 1, 1975

ORDER AND JUDGMENT

HENRY F. WERKER, D. J.

This action having come on for trial before this Court, and the issues having been duly tried and a decision having been duly rendered on August 27, 1975, and filed on August 28, 1975, and there being no just reason for delay of entry of judgment, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure.

IT IS HEREBY ORDERED, that J. Richmond Ritenour and John J. Lipsky be severed as defendants from the above-entitled case.

FURTHER ORDERED, that the above-entitled case be dismissed on the merits as to J. Richmond Ritenour and John J. Lipsky.

FURTHER ORDERED, that J. Richmond Ritenour and John J. Lipsky recover of the plaintiff their costs to be taxed.

SO ORDERED,

Dated: New York, New York
September 30, 1975

/s/Henry F. Werker
U.S.D.J.

Judgment Entered: 10-2-75

/s/Raymond F. Burghardt
CLERK

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 158 - September Term, 1976.
(Argued September 20, 1976
Decided October 26, 1976.)

Docket No. 75-7616

ROSALIE M. ARLINGHAUS, Executrix
of the Will of FRANK H. ARLINGHAUS,
and ROSALIE M. ARLINGHAUS,
individually,

Plaintiff-Appellant,

v.

J. RICHMOND RITENOUR and JOHN J. LIPSKY,

Defendants-Appellees,

and

MIRIAM PEPPER and SIDNEY PEPPER,

Defendants.

B e f o r e :

FRIENDLY, HAYS AND TIMBERS,

Circuit Judges.

Appeal by plaintiff from a judgment

of the District Court for the Southern District of New York, Henry F. Werker, Judge, which dismissed the complaint against defendants-appellees but found liability on the part of another defendant and referred the fixing of compensatory damages to a magistrate.

Appeal dismissed on the ground that the certificate directing that final judgment be entered in favor of defendants-appellees under Rule 54(b) was improvidently granted.

PREBEN JENSEN, Esq., New York, N.Y. (Casey, Lane & Mittendorf, Esqs., and Michael J. Connelly, Esq., of Counsel), for Appellant.

RAYMOND P. O'KEEFE, Esq., New York, N.Y. (Charles A. Scharf, Esq., of Counsel), for Appellees.

PER CURIAM:

This action in the District Court for the Southern District of New York

was brought in 1968 by plaintiff Rosalie M. Arlinghaus, individually and as executrix of the will of her husband Frank H. Arlinghaus. The action related to her sale, in both capacities, of shares of stock of a closely-held corporation, Modern Teleservice, Inc. (Teleservice), to defendants Ritenour and Lipsky, officers and directors of Teleservice, and to defendant Miriam Pepper, who is the wife of defendant Sidney Pepper and had been designated by him as purchaser of the stock. Pepper had served as attorney for Teleservice, for Frank Arlinghaus, its controlling stockholder, and for Mrs. Arlinghaus, individually and as executrix of Frank Arlinghaus' estate. Federal jurisdiction was based on diversity of citizenship, 28 U.S.C. § 1332, and also on § 10(b) and § 27 of the Securities Exchange Act. The com-

plaint contained five claims; certain of these were alleged against all the defendants and others only against some. A principal ground of the complaint was that the defendants allegedly had caused plaintiff to sell the Teleservice stock at what they knew was an unduly low price, in breach of their fiduciary obligations and in violation of § 10(b) of the Securities Exchange Act and the SEC's Rule 10b-5; another was that Ritenour and Lipsky, whose continued activity was important to Teleservice, allegedly had threatened to resign unless they were allowed to purchase stock. Plaintiff sought rescission or, in the alternative, compensatory damages, as well as punitive damages.

The action finally came on for a bench trial before Judge Werker in May 1975. In August 1975, the judge filed

his opinion. He dismissed all state law claims against defendants-appellees Ritenour and Lipsky. He also dismissed a conspiracy claim and the claim under the Securities Exchange Act against all defendants, and the claim against Miriam Pepper. A principal ground for dismissal of the state law claims against Ritenour and Lipsky was the finding that they had made full disclosure to Pepper of the value of Teleservice and had disclaimed any rumored threats of resignation directly to Mrs. Arlinghaus. However, the court sustained a state law claim charging Pepper with breach of his fiduciary duty, finding that, despite Ritenour's and Lipsky's disclaimers, Pepper, to their knowledge, continued to misrepresent to Mrs. Arlinghaus that Ritenour and Lipsky had threatened to resign unless she made

the stock sale and also that Pepper concealed the worth of Teleservice from her. The court refused to hold Pepper liable for any loss of potential profits sustained by Mrs. Arlinghaus on the stock sold to Ritenour and Lipsky, but did hold him liable for any profits obtained as a result of his resale of stock purchased in Mrs. Pepper's name from Mrs. Arlinghaus. The case was referred to a magistrate to determine the amount of these profits. The court also ruled that Pepper was liable for punitive damages but said it would limit these to the amount to be awarded as compensatory damages.

More than a month later, on the motion of Ritenour and Lipsky, the court entered final judgment as to these two defendants. Notice of the proposed entry of judgment was served on the at-

torneys representing Pepper and Mrs. Arlinghaus; the district court files do not reveal that either made any objection. The court, after reciting that there was "no just reason for delay of entry of judgment, pursuant to Rule 54 (b) of the Federal Rules of Civil Procedure," severed Ritenour and Lipsky as defendants and dismissed the complaint against them with costs. Plaintiff took a timely appeal. She thereafter made repeated applications for extensions of time in which to file briefs, in the hope of consolidating her appeal from Judge Werker's decision with Pepper's ultimate likely appeal when the accounting should have been completed. Although both Ritenour and Lipsky, and oddly enough defendant Pepper, initially opposed one or two of Mrs. Arlinghaus' motions to extend time, they ultimately

acquiesced in the extensions, ceasing any formal opposition. Extensions were granted over a period of six months, but finally the Staff Counsel for our Civil Appeals Management Plan evidently concluded that enough time had elapsed and denied any further extension "in the absence of exceptional circumstances." Mrs. Arlinghaus did not contest this final scheduling order, and the case thus was set on our September calendar, along with an appeal in a different action involving a dispute between Pepper on one side and Mrs. Arlinghaus and others on the other.

As could readily have been anticipated, the essence of Mrs. Arlinghaus' appeal is an attack on the district court's conclusion that disclosure to Pepper by Ritenour and Lipsky was the legal equivalent of disclosure to her.

She argues that Ritenour and Lipsky knew that Pepper was interested in obtaining Teleservice stock for less than its worth; that in pursuance of that plan he had lied to her about their threats of resignation and had continued to refer to such threats even after the disclaimer by them; and that there was every reason to believe he would not communicate to her any knowledge acquired from Ritenour and Lipsky that the Teleservice shares were worth far more than she was obtaining on the sale. If we should sustain these contentions, we would, in effect, have decided the appeal Pepper will take from the decision against him without having accorded him a right to be heard.

The case clearly demonstrates the validity of the proposition that the mere existence of multiple parties and

the dismissal of some do not afford sufficient warrant for entry of final judgment under F.R.Civ.P. 54(b) and that the required determination "that there is no just reason for delay" ought not to be made as a matter of rote -- even when, as here, there was no objection from the party who would be adversely affected or anyone else. As the late Judge Hastie said in Panichella v. Pennsylvania Railroad Company, 252 F.2d 452, 455 (3 Cir. 1958), the determination involves "weighing the overall policy against piecemeal appeals against whatever exigencies the case at hand may present.... It follows that 54(b) orders should not be entered routinely or as a courtesy or accommodation to counsel."[1] We cited this comment with

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[1] The court called attention to the Advisory Committee's note to the 1946 amendment of Rule

(footnote continued)

approval in Campbell v. Westmoreland Farm, Inc., 403 F.2d 939, 942 (2 Cir. 1968), where we dismissed an appeal, and in Schwartz v. Campagnie Generale Transatlantique, 405 F.2d 270, 274-75 (2 Cir. 1968), where we did not but suggested that when Rule 54(b) orders are granted, "the trial judge marshal the competing considerations and state the ones considered to be most important." In a more recent and even more apposite case, Gumer v. Shearson, Hammill & Co., Inc., 516 F.2d 283, 286 (2 Cir. 1974), we expressed concern lest our determination of some issues involving the defendant against whom the complaint had been dismissed "might

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(footnote continued)

54(b), which stated that the certificate provision was intended only to confer "a discretionary power to afford a remedy in the infrequent harsh case...." See 6 Moore, Federal Practice ¶54.01[6] at 53-54 (1976).

result in prejudice to the other defendants who would not have had an opportunity before us to participate in the determination of those issues," and we reiterated the desirability of district judges' not contenting themselves with repeating the conclusory language of Rule 54(b) but making "a brief reasoned statement" why there was "no just reason for delay."[2] We fear that the press of business in the district courts may have caused these suggestions to go unheeded, at least when the district judge receives so little help from the parties as here.

The benefit of such a reasoned statement is not merely that, as stressed in Gumer, it will aid us in discharging our duty to review the district

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2 See also Allis-Chalmers Corp. v. Philadelphia Electric Co., 521 F.2d 360, 364 (3 Cir. 1975), adopting the suggestion of this circuit.

court's exercise of discretion in issuing the certificate, see Sears, Roebuck & Co. v. Mackey, 351 U.S. 427, 437 (1956); Cold Metal Process Co. v. United Engineering & Foundry Co., 351 U.S. 445, 452-53 (1956), but that it will aid the district judge himself. A decisionmaker obliged to give reasons to support his decision may find they do not; "the opinion will not write." Here the only factor favoring inclusion of the certificate was that, by forcing Mrs. Arlinghaus to take an appeal immediately rather than to await the fixing of damages against Pepper, a process that should not have been lengthy,[3] Ritenour and Lipsky might be rid, if the appeal

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[3] The damages accounting was referred to a magistrate in the Southern District of New York on August 28, 1975. His report had not yet been filed with the district judge at the date of his untimely death in July 1976. We would not expect an accounting should take so long in a relatively simple case like this one.

should fail, of the cloud that has been hanging over them since 1968. This consideration was clearly outweighed by others. Not only would this court be required to review the same conduct twice, in defiance of the federal policy against piecemeal appeals, but our decision could have a profound effect on the appeal which Pepper will almost certainly take from the judgment against him and also on the appeal which Mrs. Arlinghaus may take from the judge's refusal to hold Pepper liable for the profits realized by Ritenour and Lipsky. That neither Mrs. Arlinghaus' counsel nor Pepper's counsel objected to the issuance of the 54(b) certificate is not sufficient reason to sustain the district court's action. The district court has an independent duty to avoid piecemeal appeals and protect parties'

rights against prejudice resulting from premature appeal. We are confident that if the district judge had endeavored to put pen to paper, he would ineluctably have concluded that it would be an abuse of discretion to find that there was "no just reason for delay" in entering final judgment as to defendants Ritenour and Lipsky in this case. We so hold and dismiss the appeal for want of jurisdiction.[4] No costs.

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[4] If so advised, the parties may use the briefs and appendix submitted on this appeal when the case comes here again after final judgment. Also, should the members of the present panel be available, it would promote judicial economy if the appeals were referred to them.

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the 16th day of November, one thousand nine hundred and seventy-six.

Rosalie M. Arlinghaus, Executrix of the Will of Frank H. Arlinghaus, and Rosalie M. Arlinghaus, individually,

Plaintiff-Appellant,

v.

J. Richmond Ritenour, John J. Lipsky, Miriam Pepper and Sidney Pepper,

Defendants,

J. Richmond Ritenour and John J. Lipsky,

Defendants-Appellees.

It is hereby ordered that the motion made herein by counsel for the appellant by notice of motion dated October, 1976, to amend the judgment of October 26, 1976, by adding thereto an express provision vacating the order and judgment entered by the District Court pursuant to Rule 54(b) be and it hereby is granted.

HENRY J. FRIENDLY

PAUL R. HAYS

WILLIAM H. TIMBERS

Circuit Judges

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ROSALIE M. ARLINGHAUS, Executrix of the Will of Frank H. Arlinghaus, and ROSALIE M. ARLINGHAUS, individually,

Plaintiff,

-against-

J. RICHMOND RITENOUR, JOHN J. LIPSKY, MIRIAM PEPPER and SIDNEY PEPPER,

Defendants.

Filed March 6, 1979
Entered March 7, 1979

JUDGMENT

This action having come on for trial before the Court (Werker, J) without a jury May 12, 1975, and trial having proceeded on May 12, 13 and 14, 1975; and the Court having rendered its decision August 28, 1975, dismissing the action against defendants J. Richmond Ritenour, John J. Lipsky and Miriam Pepper, awarding compensatory and punitive damages to plaintiff in both of her capacities against defen-

dant Sidney Pepper, ordering defendant Sidney Pepper to account to plaintiff for his profits and referring the action to a Magistrate for that purpose; and the Court having entered its order and judgment dated October 1, 1975 severing defendants J. Richmond Ritenour and John J. Lipsky from this action and dismissing the action on the merits as to the said two defendants; and the Court of Appeals for the Second Circuit having rendered a decision on appeal October 26, 1976 reversing the Court's order severing defendants J. Richmond Ritenour and John J. Lipsky from the action and having by order dated November 16, 1976 amended its judgment of October 26, 1976 by adding thereto an express provision vacating the order and judgment of this Court entered October 1, 1975; and the Court having

entered an order February 18, 1977 substituting Miriam Pepper, as executrix of the will of Sidney Pepper for defendant Sidney Pepper, deceased; and the Magistrate (Nina Gershon) having filed her report and recommendation November 9, 1978; and the Court having filed its memorandum and order February 22, 1979 adopting and confirming in all respects the report and recommendation of the Magistrate except as modified by addition of the sum of $2,201.01 in the award made to plaintiff pursuant thereto; it is

ORDERED, ADJUDGED and DECREED that plaintiff, Rosalie M. Arlinghaus, as executrix of the will of Frank H. Arlinghaus, recover from defendant Miriam Pepper, as executrix of the will of Sidney Pepper, compensatory damages in the sum of $176,837.40 and punitive

damages in the sum of $176,837.40, with interest from August 8, 1977 in the amount of $33,592.03 making in all the sum of $387,266.83, with costs to be taxed by the Clerk of the Court; and it is further

ORDERED, ADJUDGED and DECREED that plaintiff, Rosalie M. Arlinghaus, individually, recover from Miriam Pepper, as executrix of the will of Sidney Pepper, compensatory damages in the sum of $77,696.59 and punitive damages in the sum of $77,696.59, with interest from August 8, 1977 in the amount of $14,759.24, making in all the sum of $170,152.42, with costs to be taxed by the Clerk of the Court; and it is further

ORDERED, ADJUDGED and DECREED that the actions against defendants J. Richmond Ritenour, John J. Lipsky and

Miriam Pepper are dismissed, with costs to defendants J. Richmond Ritenour and John J. Lipsky in the amount of $400.86.

/s/Henry F. Werker
U.S.D.J.

Dated: New York, New York
March 7th, 1979

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the first day of July, one thousand nine hundred and eighty.

Present: HON. WALTER R. MANSFIELD HON. AMALYA L. KEARSE HON. HENRY J. FRIENDLY

Circuit Judges

ROSALIE M. ARLINGHAUS, Executrix of the Will of Frank H. Arlinghaus, and ROSALIE M. ARLINGHAUS, individually,

Plaintiff-Appellant

-against-

J. RICHMOND RITENOUR, JOHN J. LIPSKY, MIRIAM PEPPER and SIDNEY PEPPER,

Defendants

J. RICHMOND RITENOUR and JOHN J. LIPSKY,

Defendants-Appellees.

Filed Jul. 1, 1980

Docket No. 79-7483
(79-7474)

A petition for a rehearing having been filed herein by counsel for the plaintiff-appellant,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

/s/ A. DANIEL FUSARO,
Clerk

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the first day of July, one thousand nine hundred and eighty.

ROSALIE M. ARLINGHAUS, Executrix of the Will of Frank H. Arlinghaus, and ROSALIE M. ARLINGHAUS, individually,

Plaintiff-Appellant

-against-

J. RICHMOND RITENOUR, JOHN J. LIPSKY, MIRIAM PEPPER and SIDNEY PEPPER,

Defendants

J. RICHMOND RITENOUR and JOHN J. LIPSKY,

Defendants-Appellees.

Filed Jul. 1, 1980

Docket No. 79-7483
79-7474

A petition for a rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the plaintiff-appellant, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

/s/ Wilfred Feinberg
Chief Judge